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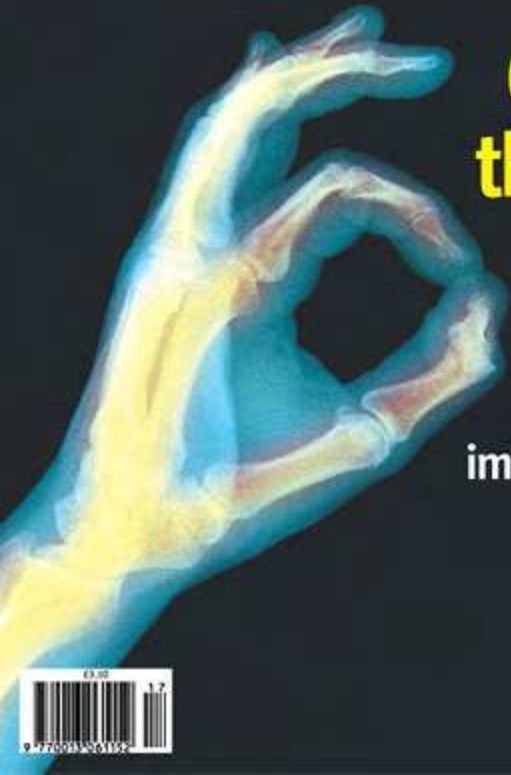

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Business this week

Apr 21st 2005
From The Economist print edition

If you can't beat 'em, join 'em

The New York Stock Exchange said that it was joining forces with Archipelago, an electronic exchange. If the deal goes through, the new company, of which the **NYSE**'s owners will have 70%, will be a listed, for-profit entity, ending its mutual status.

See article

Pernod Ricard, the world's third-largest spirits firm, is teaming up with **Fortune Brands** to buy **Allied Domecq**, the second-biggest distiller, for around $14 billion in stock and cash.

See article

The world's biggest carmaker, **General Motors**, lost $1.1 billion in the quarter, its worst quarterly loss since 1992. It also abandoned its profit forecast for the year. **Ford Motor** said quarterly net income fell by 38% to $1.21 billion.

See article

Pfizer, the world's largest drug maker, said quarterly earnings dropped by 87% to $301m, due to a tax charge and costs to suspend sales of a drug. Meanwhile, **Eli Lilly** reported an 84% increase, earning $737m. **Johnson & Johnson** announced record profits and sales, and **Roche Holding** posted a 14% jump in quarterly revenue.

America's Supreme Court heard arguments this week in a case between **Merck**, a German drug firm unrelated to the American company, and **Integra LifeSciences**, a medical device firm, over the leeway researchers have to use technologies without infringing patents.

See article

Time Warner and **Comcast**, America's two biggest cable-television firms, agreed to buy their fifth-largest rival, bankrupt Adelphia Communications, for $17.6 billion. Their offer beat a last-minute bid from Cablevision, a smaller cable-TV company.

Viacom said quarterly profit fell by almost 18% to $585m on lower revenue at its CBS television unit, but the company cited a 19% revenue gain in its cable networks division. Viacom reiterated it is considering a breakup into a broadcast-TV entity and cable units.

Adobe Systems said it will acquire **Macromedia** for $3.4 billion in stock, a deal that unites two of the largest digital document and online publishing firms. Adobe's PDF format is a standard for documents on computers, and Macromedia makes “flash” animation for web pages.

Looking chipper

The chipmaker **Intel** said quarterly profits rose by around 25% to $2.15 billion on revenue of $9.4 billion, a sign of increased demand for higher-end computers. The firm also raised its profit-margin expectations.

See article

Ebay's first-quarter profits rose 28% to $256m on revenue of $1 billion on strong international sales, which may soon surpass those in America.

Conrad Black resigned as boss of Ravelston, a private firm through which he ran his media empire until a revolt in one part of it, Hollinger International, by minority shareholders. Ravelston is seeking bankruptcy protection.

US **Airways** is reportedly in merger talks with **America West** to create a national low-cost airline. A merger could be the first step in airline-industry consolidation. **Continental Air's** quarterly loss widened to $184m due to fuel costs and competition.

Royal Dutch/Shell Group is selling its interest in the power-plant **InterGen** for $1.75 billion to the private-equity arms of American International Group and the Ontario Teachers' Pension Plan.

J.P. Morgan Chase's net income rose by 17% to $2.26 billion and revenue increased by 51% in the quarter boosted by its acquisition of Bank One. **Bank of America** hit record quarterly earnings of $4.7 billion, up by 75%, thanks in part to its acquisition of FleetBoston as well as trading gains.

Hope springs eternal

RAG, a German mining conglomerate, applied to open a coal mine in North Rhine-Westphalia that would create 2,500 jobs and produce 3m tonnes a year. Some believe the plan is motivated by state elections in May, because by most estimates it costs more to produce coal in Germany than its market value.

China's **gross domestic product** grew by 9.5% in the quarter compared to a year earlier, fuelled by surging domestic demand. Among the gains was a 22.8% growth in investment in fixed assets.

See article

New housing starts in America plunged by 17.6%, the biggest monthly drop in more than 14 years, according to the Commerce Department. The fall fuels fears that the housing boom may be slowing.

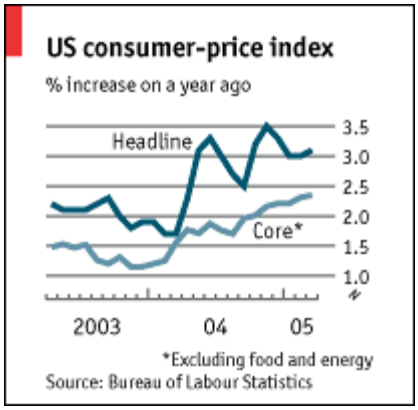
See article

Up and down

America's **consumer price index** jumped by a larger-than-expected 0.6% in March, increasing worries about inflation. The

gain, the largest in five months, suggests companies are passing along higher costs of energy and other commodities.

See article



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Politics this week

Apr 21st 2005
From The Economist print edition

New pope

AP

The conclave of cardinals elected a **new pope**, Cardinal Joseph Ratzinger, who took the name Benedict XVI. The choice pleased traditionalists but dismayed liberals: Cardinal Ratzinger, an arch-conservative German, was John Paul II's chief theological enforcer.

See article

Silvio Berlusconi resigned as prime minister of **Italy**, with the aim of re-forming a government with the same centre-right parties. The kerfuffle was triggered by the centre-right's appalling performance in recent regional elections.

See article

In the **Basque country's** regional election, the moderate nationalist ruling party lost ground and the Socialists gained seats. The Spanish government hailed the election as signalling the end of moves towards Basque independence, though it also said it was willing to keep negotiating with the Basques.

See article

In **Cyprus**, Turkish-Cypriots returned Mehmet Ali Talat as president in place of the veteran obstructionist, Rauf Denktash. Mr Talat is keen on reunification of the island, but his Greek-Cypriot counterpart, Tassos Papadopoulos, is now the intransigent party.

See article

Bickering within the **French government** over the faltering campaign for a yes vote in its **EU** referendum intensified when Dominique de Villepin, the interior minister, suggested that France might need a new prime minister (eg, himself). Jean-Pierre Raffarin, the incumbent, later said that he had brought Mr de Villepin back into line.

See article

Power sharing

Nearly three months after a general election, **Iraq's** prime minister-designate, Ibrahim al-Jaafari, was poised to appoint a government in which Shia and Sunni Arabs and Kurds share out the top jobs. The outgoing interim prime minister, Iyad Allawi, narrowly escaped assassination by a suicide-bomber.

In one of the worst clashes in **Afghanistan** in recent months, US forces reacted to a rocket attack on one of their bases by blasting insurgents with rockets, bombs and artillery, killing at least 12.

After being nominated as **Lebanon's** prime minister, Najib Mikati, a Sunni Muslim who is a moderately pro-Syrian MP, named a cabinet in which both pro-Syrian loyalists and opposition-backed figures who want Syria to keep out of Lebanon have big posts.

Some 200 Arab **Iranians** were reported to have been arrested in Ahwaz, in the southern province of Khuzestan, after riots followed publication of a letter alleged to have been written by the government (which denies it) saying that the province would be reorganised to dilute the strength of the Arab population and to change Arab place-names to Persian ones.

Sudan said it had found “abundant” quantities of oil in its western region of Darfur. The Sudanese government's campaign of ethnic cleansing against non-Arabs in Darfur continued.

An exiled opposition leader from **Equatorial Guinea** was reported missing and possibly murdered. The country's despotic regime had accused Severo Moto of being behind an alleged coup plot last year.

Unrest in Ecuador

Ecuador's Congress voted to oust the country's elected president, Lucio Gutiérrez, who took refuge in the Brazilian embassy in the capital, Quito. Alfredo Palacio, the vice-president, was sworn in as his replacement.

See article

Canada's minority Liberal government published a long-awaited foreign policy review. It proposes to concentrate defence efforts on North America and target aid more closely. The review came amid talk that the opposition will seek to bring down the government, triggering an election.

The FARC guerrillas besieged a small Andean Indian town in southern **Colombia**, killing at least seven police and troops and a small boy, and wounding dozens of people.

A United Nations delegation visited **Haiti** and said that more security was needed if an election is to be held on schedule in November.

Jeffords and Hyde

Senator Jim Jeffords, who deserted the Republicans to become an independent in 2001, announced he would retire at the end of 2006, creating the first open seat in **Vermont** since 1988. Henry Hyde, an anti-abortion stalwart and one of the congressmen who led the attempt to impeach Bill Clinton, is also going.

Republicans on the ethics committee in the House of Representatives agreed to open an investigation into allegations of wrongdoing by **Tom DeLay**, the majority leader.

EPA

See article

In a blow to George Bush, a Senate committee postponed, until next month, a vote on the nomination of John Bolton to become the next **American ambassador to the United Nations**. The White House moaned about the Democrats dragging up “unfounded allegations”.

America's largest **teachers' union**, The National Education Association, filed a lawsuit that would allow school districts to opt out of George Bush's No Child Left Behind Act unless the federal government pays for the reforms.

An end in sight?

Reuters

China's government called for an end to **anti-Japan protests**. However, it did not apologise to Japan for damage done to its diplomatic missions by stone-throwing mobs. The Japanese foreign minister, Nobutaka Machimura, said both sides were working positively to achieve a meeting between Japan's prime minister, Junichiro Koizumi, and China's president, Hu Jintao.

See article

North Korea claimed to have shut down a nuclear reactor, prompting fears that it might reprocess nuclear fuel to make more atomic weapons. A North Korean diplomat said the country planned to “increase our deterrent" against military strikes”.

In the **Philippines**, the government and a separatist Muslim rebel group said they had made significant progress towards ending a slow-burning 30-year insurgency.

A human rights group accused **Myanmar's** army of using chemical weapons against rebels on its northern border. The military government declined to comment.

A report by Amnesty International claims that more than 3,000 political prisoners have been detained in **Nepal** since the king seized power.

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Economist.com OPINION

Environmental economics

Rescuing environmentalism

Apr 21st 2005
From The Economist print edition

Market forces could prove the environment's best friend—if only greens could learn to love them

Get article background

“THE environmental movement's foundational concepts, its method for framing legislative proposals, and its very institutions are outmoded. Today environmentalism is just another special interest.” Those damning words come not from any industry lobby or right-wing think-tank. They are drawn from “The Death of Environmentalism”, an influential essay published recently by two greens with impeccable credentials. They claim that environmental groups are politically adrift and dreadfully out of touch.

They are right. In America, greens have suffered a string of defeats on high-profile issues. They are losing the battle to prevent oil drilling in Alaska's wild lands, and have failed to spark the public's imagination over global warming. Even the stridently ungreen George Bush has failed to galvanise the environmental movement. The solution, argue many elders of the sect, is to step back from day-to-day politics and policies and “energise” ordinary punters with talk of global-warming calamities and a radical “vision of the future commensurate with the magnitude of the crisis”.

Europe's green groups, while politically stronger, are also starting to lose their way intellectually. Consider, for example, their invocation of the woolly “precautionary principle” to demonise any complex technology (next-generation nuclear plants, say, or genetically modified crops) that they do not like the look of. A more sensible green analysis of nuclear power would weigh its (very high) economic costs and (fairly low) safety risks against the important benefit of generating electricity with no greenhouse-gas emissions.

Small victories and bigger defeats

The coming into force of the UN's Kyoto protocol on climate change might seem a victory for Europe's greens, but it actually masks a larger failure. The most promising aspect of the treaty—its innovative use of market-based instruments such as carbon-emissions trading—was resisted tooth and nail by Europe's greens. With courageous exceptions, American green groups also remain deeply suspicious of market forces.

If environmental groups continue to reject pragmatic solutions and instead drift toward Utopian (or dystopian) visions of the future, they will lose the battle of ideas. And that would be a pity, for the world would benefit from having a thoughtful green movement. It would also be ironic, because far-reaching advances are already under way in the management of the world's natural resources—changes that add up to a different kind of green revolution. This could yet save the greens (as well as doing the planet a world of good).

“Mandate, regulate, litigate.” That has been the green mantra. And it explains the world's top-down, command-and-control approach to environmental policymaking. Slowly, this is changing. Yesterday's failed hopes, today's heavy costs and tomorrow's demanding ambitions have been driving public policy quietly towards market-based approaches. One example lies in the assignment of property rights over “commons”, such as fisheries, that are abused because they belong at once to everyone and no one. Where tradable fishing quotas have been issued, the result has been a drop in over-fishing. Emissions trading is also taking off. America led the way with its sulphur-dioxide trading scheme, and today the EU is pioneering carbon-dioxide trading with the (albeit still controversial) goal of slowing down climate change.

These, however, are obvious targets. What is really intriguing are efforts to value previously ignored “ecological services”, both basic ones such as water filtration and flood prevention, and luxuries such as preserving wildlife. At the same time, advances in environmental science are making those valuation studies more accurate. Market mechanisms can then be employed to achieve these goals at the lowest cost. Today, countries from Panama to Papua New Guinea are investigating ways to price nature in this way (see article).

Rachel Carson meets Adam Smith

If this new green revolution is to succeed, however, three things must happen. The most important is that prices must be set correctly. The best way to do this is through liquid markets, as in the case of emissions trading. Here, politics merely sets the goal. How that goal is achieved is up to the traders.

A proper price, however, requires proper information. So the second goal must be to provide it. The tendency to regard the environment as a “free good” must be tempered with an understanding of what it does for humanity and how. Thanks to the recent Millennium Ecosystem Assessment and the World Bank's annual “Little Green Data Book” (released this week), that is happening. More work is needed, but thanks to technologies such as satellite observation, computing and the internet, green accounting is getting cheaper and easier.

Which leads naturally to the third goal, the embrace of cost-benefit analysis. At this, greens roll their eyes, complaining that it reduces nature to dollars and cents. In one sense, they are right. Some things in nature are irreplaceable—literally priceless. Even so, it is essential to consider trade-offs when analysing almost all green problems. The marginal cost of removing the last 5% of a given pollutant is often far higher than removing the first 5% or even 50%: for public policy

to ignore such facts would be inexcusable.

If governments invest seriously in green data acquisition and co-ordination, they will no longer be flying blind. And by advocating data-based, analytically rigorous policies rather than pious appeals to “save the planet”, the green movement could overcome the scepticism of the ordinary voter. It might even move from the fringes of politics to the middle ground where most voters reside.

Whether the big environmental groups join or not, the next green revolution is already under way. Rachel Carson, the crusading journalist who inspired greens in the 1950s and 60s, is joining hands with Adam Smith, the hero of free-marketeers. The world may yet leapfrog from the dark ages of clumsy, costly, command-and-control regulations to an enlightened age of informed, innovative, incentive-based greenery.

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Spain and its regions

Clarity needed

Apr 21st 2005
From The Economist print edition

How to respond to perennial demands from separatists in Spain

Get article background

IT IS the problem that won't go away. Ever since Spain adopted its present constitution in 1978, its restive regions, especially the Basque country and Catalonia, have agitated for more autonomy from Madrid. As it happens, voters in last weekend's Basque elections gave a rebuff to their nationalist premier, Juan José Ibarretxe, who had hoped for stronger support so that he could hold a referendum on the right to form a "free state associated with Spain". But even if the Ibarretxe plan is dead in its present form, demands for more autonomy and even, one day, for independence seem sure to persist.

It thus behoves the government in Madrid to work out carefully how to respond. Successive Spanish governments have been willing to concede plenty of autonomy. But they have rigidly refused to contemplate any possibility of secession. The tone was set by the previous People's Party government under José María Aznar, who refused even to meet Mr Ibarretxe, arguing that any negotiation, even with moderate Basque nationalists, would not only threaten the territorial integrity of Spain but also represent a concession to the Basque terrorists, ETA, whose political wing was banned.

Mr Aznar's Socialist successor, José Luis Rodríguez Zapatero, has been more flexible. There are encouraging hints, after the Basque election, that he may now negotiate a deal with Mr Ibarretxe that could lead to a revised plan, including extra autonomy but stopping short of full independence, being put to the vote (see article). A ceasefire by ETA, now bizarrely represented in the Basque parliament by the local Communists, would have to be part of the deal. Yet the formal position in Madrid remains that any vote on independence, by any region, is unconstitutional and cannot be allowed.

Nobody should advocate concessions to men of violence. Yet a refusal to listen to peaceful demands for independence is short-sighted. Worse, it is likely to be counter-productive. Mr Aznar's intransigence seems to have served largely to bolster the nationalist vote in the Basque country. The latest election suggests that Mr Zapatero's flexibility may instead be weakening it. The best policy now would be for Mr Zapatero to go a stage further, by accepting that, if a majority of any region's people ever peacefully decides that they want independence, the government in Madrid should be ready to negotiate.

Such a course has been followed successfully in Canada over Quebec. Rather than asserting that any demand for independence by Quebec was illegal, the federal government decided, following a Supreme Court ruling, to pass the so-called Clarity Act in 2000. This act sets out the conditions which Quebec (or any other province) would have to fulfil if it wished to secede: it would have to hold a referendum on a simple and clear question; it would have to secure a clear majority in

favour; and it would then have to negotiate the terms of its departure with the government in Ottawa.

The benefit of the Clarity Act is not just that it sets out a procedure for peaceful secession, if a majority of a region wants it. It is that it seems, at least for now, to have defused the demand for secession itself. Countries will not always hold together, especially when there have been wars: in the next few years both Kosovo and Montenegro are likely to break free of Serbia, for example. But experience has often shown that, when the notion of secession is stamped on, pressure for it only rises—whereas, if secession is clearly permitted, many would-be secessionists cease to press so hard for it.

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History, riots and trade rows

The China question

Apr 21st 2005
From The Economist print edition

Asia's real boat-rocker is a growing and undemocratic China, not democratic Japan

RTR/EPA

THERE is so much noise surrounding and emanating from the world's miracle economy that it is becoming cacophonous. In Washington, DC, the latest idea is that China is becoming too successful, perhaps even dangerously so: while Capitol Hill resounds with complaints of trade surpluses and currency manipulation, the Pentagon and sundry think-tanks echo to a new drumbeat of analysts worrying about China's 12.6% annual rise in military spending and about whether it might soon have the ability to take pre-emptive military action to force Taiwan to rejoin it. So it may be no coincidence that for three consecutive weekends the streets of big Chinese cities have been filled with the sounds of demonstrators marching and rocks being thrown, all seeking to send a different message: that Japan is the problem in Asia, not China, because of its wanton failure to face up to its history; and that by cosying up to Japan in security matters, America is allying with Asia's pariah.

Deafness is not the only risk from all this noise. The pressure towards protectionism in Washington is strong (see article), and could put in further danger not only trade with China but also the wider climate for trade liberalisation in the Doha round of the World Trade Organisation (WTO). So far words have been the main weapons used between China and Japan, but there is a chance that nationalism in either or both countries could lead the governments to strike confrontational poses over their territorial disputes in the seas that divide them, even involving their navies. And the more that nationalist positions become entrenched in both countries but especially China (see article), the more that street protests could become stirred up, perhaps towards more violence.

All these issues are complex ones and, as is often the case in trade and in historical disputes, finding solutions is likely to be far from simple. A revaluation of the yuan, as demanded in Congress, would not re-balance trade between America and China, though it might help a little, in due course. A “sincere” apology by Japan for its wartime atrocities might also help a little, but it would not suddenly turn Asia's natural great-power rivals into bosom buddies. For behind all the noise lies one big fact: that it is the rise of China, not the status or conduct of Japan, that poses

Asia's thorniest questions.

Echoes of the 1930s

But doesn't Japan have much to apologise for? And hasn't it failed to match Germany's postwar blend of contrition and compensation? Yes, it does have a lot to apologise for, and yes, it has failed to do as much as Germany. But it would not take all that much to remedy those faults.

Japan has apologised countless times to China as to its other Asian victims, using all the right words. Its problem is that it has undermined those apologies in three main ways: by forcing recipient governments to negotiate over the phraseology to be used, making the apology feel reluctant and purely pragmatic; by failing to match declarations of guilt with the proper taking of responsibility, in particular through adequate compensation for Asian individuals who suffered from its atrocities; and, since 2001, by its prime minister's visits to the Yasukuni shrine, a private entity that honours war criminals as well as Japan's general war dead. Taken together, these failings weaken the government's claim that the nation is officially contrite, even if small groups of right-wingers are not.

If Japan's government were to launch efforts to deal with those three things, then the pluralism that, through those right-wingers, currently damages it would turn into a strength. Japan, unlike China, is a democratic and peaceful society in which disputes and even nasty debates can be handled safely. Japan poses no danger to its neighbours. Rather, another country is coming to resemble the Japan of the 1920s and 1930s: one that is developing rapidly, is hungry for energy and other natural resources, and whose nationalist politics sometimes spills worryingly into its streets. That country is China.

This does not mean that China looks poised to repeat Japan's ghastly 20th-century history. But it does mean that China, for all its new official mantra about its “peaceful rise”, is nevertheless the region's, and even the globe's, boat-rocker. Its past willingness to bind itself into global rule-based systems such as the WTO has been a welcome way to channel its growth. The country's new leadership needs to follow that same path: by adapting its currency system to reflect changing conditions, for example, and by seeking ways to defuse tensions with Japan, not to exploit them. The Japan question will fade. The China question is only going to get louder.

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Economist.com OPINION

Helping poor countries

Dithering on debt

Apr 21st 2005
From The Economist print edition

If rich countries really believe in debt forgiveness, they should sell some IMF gold to pay for it.

ANOTHER gathering of finance ministers. More talk about relieving poor countries' debts. And, once again, no agreement. Last weekend's spring meeting of the IMF and World Bank was the latest move in the exasperating charade that is the debt-relief debate. It is time for this charade to end.

Thanks to a curious alliance between rock stars and aid activists, advocating debt relief has become the development-policy equivalent of kissing babies. Every politician does it. The G7 recently promised to forgive up to 100% of the debts owed to multilateral institutions, such as the IMF and World Bank, by the world's poorest debtors. But behind the generous pledges are deep divisions about what debt relief is really for.

On one side are the British, for whom debt relief is primarily a popular way to raise aid flows to poor countries. That is why Gordon Brown, Britain's finance minister, insists that the money should be “additional”. He wants rich countries to pay debt service that poor countries owe the World Bank and other development banks. And he wants to sell some of the IMF's stash of gold to pay for the write-off of its loans.

For the Bush administration, debt forgiveness is more about acknowledging past failures and changing the way aid is delivered. America's Treasury wants to write off the debts of the poorest and give them only grants in future. But it sees no need for new resources to pay for this. After writing off its loans, the World Bank would simply give commensurately less aid to those countries in future. Fretting about “new money” or gold sales, argue the Americans, is an unnecessary distraction from getting rid of loans that will never be repaid.

Both sides have a point. The Americans are right that the current cycle of defensive lending—in which a chunk of new money lent by the World Bank is sent straight back to Washington as debt-service payments on old debt—seems absurd. Far better to write off what will never be paid.

But the British are right to argue that simply writing off the debt does nothing to raise the amount of money going to the world's most desperate. And it risks weakening the Bank's capacity to lend to the poor in future. The political momentum of the debt-relief campaign suggests that ever more countries will be included, even ones, such as Nigeria, that could be quite rich if better governed. Writing off debts from countries that could, eventually, repay will reduce the future flows of cash to the Bank's coffers, and hence its ability to lend later to others. Despite (or perhaps because of) the recent appointment of Paul Wolfowitz to lead it, many Europeans suspect that weakening the Bank is, in fact, America's real purpose.

The Bank could indeed be financially weakened. Mr Bush's team prefers untested bilateral aid vehicles, such as the Millennium Challenge Account (see article), to putting more resources into the multilateral pot. And America's share of contributions to the Bank's soft-loan arm has fallen sharply.

To weaken the Bank and IMF would be unwise. The best debt-relief plan would therefore take a little from each side. The British should accept America's approach to debt forgiveness as simpler and more efficient than their own plans for paying debt-service on poor countries' behalf. In return, the Bush administration should support selling a portion of the IMF's gold, both to pay for some IMF debt forgiveness, as the British suggest, and to bolster the World Bank's soft-loan arm.

Selling IMF gold is not cost-free. The Fund's reserves of 103m ounces (worth around $45 billion at market prices, but valued at only $9 billion on the IMF's books) were given by rich countries to bolster the Fund's balance sheet. Less gold would leave the IMF with fewer resources for use in coping with a financial crisis. Massive sales could roil gold markets—one reason why many American senators, under pressure from gold-mining firms, have already voiced loud opposition.

These concerns are real, but not overwhelming. Many central banks have been selling gold without crashing the market. The Fund could do so too. With less gold, the IMF would be marginally less secure, but still far from financial fragility. In return, the effectiveness of debt relief and the pot of useful foreign aid would get a much-needed boost. If rich countries want to make good on their promises, the benefits of tapping some IMF gold surely outweigh the risks.

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Economist.com OPINION

Corporate strategy

Time to put ideas into practice

Apr 21st 2005
From The Economist print edition

Companies should shift their attention from cost-cutting to business-building

BOSSES seem to have lost their nerve. After the over-exuberance of the dotcom boom they wisely focused on cutting costs. And they have been very successful at it. Switching their manufacturing to low-cost developing countries (to China in particular) and outsourcing their business processes to specialists with higher skills and economies of scale have brought about dramatic savings. So has simply making fewer costly if adventurous mistakes. The evidence is visible on firms' balance sheets and bank statements.

And yet many companies seem to have become so hooked on cost-cutting that a sort of anorexia has set in. That cannot be healthy in the longer term. Cost-cutting is an effective way to increase earnings, but it has its limits. In a recent article, consultants at Booz Allen Hamilton warn that "sourcing in China can become a source of woe". A consultant at Hewitt Associates, a human-resources consultancy, says, "If you think China is a cheap place for labour, think again." Shortages of skilled workers there are rapidly pushing up prices.

In any case, cheap labour is not always as cheap as it seems. There is a price to being Scrooge. Costco, a big American retailer, pays its staff over 50% more than the industry average. Not only does it get a chance to employ higher-quality staff—there were 5,000 applicants for 160 jobs available when it opened a store recently in Michigan—but its staff turnover rate is a mere 6% compared with the industry's average of 59%.

Many companies, realising that their biggest cost item is purchased materials, have been regularly switching suppliers in an elusive search for the cheapest. Not only are the transaction costs of this high, but it also destroys any longer-term trust with suppliers. A recent study of the aerospace industry found that the assumption of the industry's giant manufacturers that they could indefinitely force their suppliers to lower prices led those suppliers to sell some replacement parts directly to the airlines, bypassing the aerospace firms.

A bigger reason to worry is that many firms have not yet found good uses for the cash raised through cost-cutting. In America and Europe, some are beginning to dabble in mergers and acquisitions. But M&A has such a bad track record that it will be a lucky (and skilful) minority who can create and sustain value from their deals. A recent McKinsey study found that 70% of mergers fail to produce expected gains in revenues.

It would be much better in most cases to redistribute the money to shareholders, which fortunately is what many firms are doing. In America and Europe, companies are buying back their shares like never before, one of the most convenient ways to distribute cash. Last year the S&P 500 companies repurchased a record $197 billion-worth; this year the figure is expected to be even higher.

This is much wiser, but it is also a kind of admission that the firms' managers cannot find something to do with their assets, skills and cash that they believe will earn their shareholders a return greater than that to be gained from squirrelling the cash away in a bank (which, let's face it, is no great hurdle these days). Shareholders might rightly take a dim view of the long-term prospects of a firm which went too far down this route. Some firms may already be wondering whether they have done so. Intel and Yahoo!, two companies which recently announced share buybacks, reported surprisingly big increases in first-quarter profits and revenues this week. Yahoo! found the online advertising market unexpectedly buoyant, and Intel found (to its surprise) that it can sell premium-priced chips—which persuaded it to announce a 10% increase in its investment on plant and equipment this year.

Innovate and differentiate

With so much stress on cutting costs, there is reason to fear that too few companies are investing in innovative new ideas that might generate organic growth. The paucity is not due to a shortage of advice. Books and articles on innovation and how to generate new businesses are as plentiful as ever. The cover story of next month's issue of the *Harvard Business Review* is entitled “Building Breakthrough Businesses Within Established Organisations”, and describes how Corning, a glass manufacturer, and the New York Times Company recently made bold strategic experiments work. Michael Porter, a leading theorist on competitive strategy, has long argued that firms gain advantage either through lower costs or through a differentiation of their products that can command a premium price. With so many firms stressing cost-cutting, it might be clever to try, like Intel, to stand out from the crowd.

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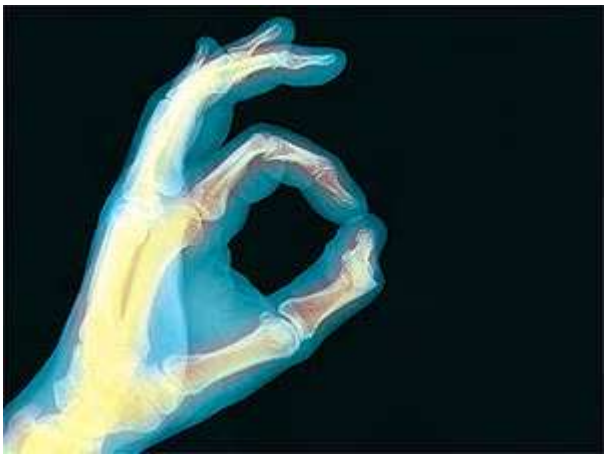
Health in Britain

Getting it right

Apr 21st 2005
From The Economist print edition

Labour messed the National Health Service up to start with, but is now getting it right



Get article background

IN ALMOST every poll in the past five years, Britons have rated the health service as the single most important issue facing the country. They are sure to think so still when they cast their votes on May 5th. There are three likely explanations. First, as the population has got older, it has become preoccupied with the service that is going to look after it in its dotage. Second, as people have got richer, they have become discontented with a service that is poorer and worse than those in most other rich countries. And, third, as the government has poured money into the NHS, people have become understandably concerned about what they are getting in return.

The answer, so far, is not a lot. The returns from these many extra billions have been disappointing. That, however, should soon start to change.

Cash transfusion

The health service's budget has doubled over the past eight years. This has pushed total health spending up to 8.4% of GDP and it is due to rise to 9.2%—higher than the current level in continental Europe, though lower than in America—by 2007-08.

The NHS has not improved commensurately. Waiting times, for instance—a big focus of government effort—have fallen, and people no longer have to wait years for operations. But there are still 845,000 people on the list. More importantly, although the service's budget rose in real terms by over 7% a year from 1998 to 2003, its real output rose by only 3.7% a year.

It's the government's fault. When the Tories were in power, they made hospitals compete for business and thus pushed up health-service productivity. Labour scrapped those reforms. Instead of letting market mechanisms work inside the health service, it relied on top-down targets to force hospitals to perform better. Doctors complain that these targets interfere with clinical priorities: the spread of the hospital superbug MRSA, for instance, is blamed partly on waiting-time targets which put pressure on hospitals to squeeze in as many patients as possible rather than take care to ensure that hospital-acquired infections do not spread.

If it is judged on the NHS's performance so far, the government has not done well. But it has learnt an expensive lesson: that cash is no good without reform. Having wasted much of its first term, it has concentrated in its second on putting into place an ambitious reform programme (see article), for which it deserves high marks.

The government has reintroduced the internal market, but on a more ambitious scale than in the 1990s. The biggest change is to the payments system. Under the old system, hospitals were paid a block budget, so every patient represented a cost. Now, money will follow patients, so that they bring income as well. The new system is already starting for elective operations and applies to most health care provided by “foundation” hospitals. Thirty-one hospital trusts now have this privileged status, which allows them to keep the surplus they make from treating patients, so that the more efficiently they treat more patients, the more money they have to reinvest. All acute-care hospital trusts are supposed to become eligible for these freedoms by 2008.

Labour's boldest step has been to complement the internal market with an external one. It has turned to the private sector, contracting out more and more NHS work to independent firms. This landmark decision has buried the dogma that public financing of health care must mean that it is also publicly provided. Already, by the end of this year, private providers will carry out around 4% of publicly financed elective treatments. Labour says it wants this share to rise towards 15% within a few years. The new policy has led to a welcome shake-up among Britain's private health-care providers, as they gear up for a high-volume, low-cost future in which they compete for a substantial chunk of the big NHS market.

Getting these reforms past Labour's left wing was hard. But the harder part is yet to come. The payment-by-results system will show up inefficiencies in the system and, if carried to its logical conclusion, will lead to hospital closures and mergers. Whether to allow this to happen, or to prop hospitals up and thus reduce the possible efficiency gains, will be a hard test for the next government.

Doctor Blair's medicine

Tony Blair deserves much of the credit for all this. Pushing through these reforms did him no short-term good, and cost him a lot of political capital when his stock was already depleted by the war. He will be gone soon enough, either because he loses the election (unlikely) or because he steps down in a year or three (which he has anyway promised to do before the 2009-10 election). What are the prospects for the reformed health service once he has gone?

Should a miracle bring the Conservative Party victory on May 5th, the health service looks reasonably safe. True, the Tories failed to do anything much to improve the NHS during their own first two terms (in 1979-87), and their subsequent reforms did not go anything like as far as Labour's have. Yet they did start the process, and their policies now clearly acknowledge that Labour has gone in the right direction. In fact, despite loud protests to the contrary, the two parties' policies are now hard to tell apart.

Oddly, if Labour holds on to power, the future looks a little less clear. Gordon Brown, the

chancellor of the exchequer, is almost certain to take over when Mr Blair goes. He is more sceptical about the role of markets in public services: one of his big public battles with the prime minister was his desire to limit foundation hospitals' freedom (he won). Yet Mr Brown is a practical man who is sharply aware of the need to boost productivity in the health service, so if these reforms start delivering he is unlikely to dismantle them on ideological grounds. Thus, whoever is returned on May 5th, the reforms will probably survive.

On the eve of the 1997 election, Mr Blair told voters that they had 24 hours to save the NHS. Eight years on, the NHS is not yet in good health; but it is, at least, on the mend.

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Letters

Apr 21st 2005
From The Economist print edition

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

Pope John Paul II

SIR – Claims that the Catholic church "has lent support to dictators" and "exacerbated the problems of the most vulnerable, especially women", is a travesty of reality in 99% of the Catholic church's actual activity ("The future of the church", Moreover, you discard your traditional liberal and tolerant credentials by questioning the right (for the sake of mutual respect) of the church and Catholics in general to hold views on matters, such as abortion, euthanasia or same-sex unions, that do not coincide with yours.

Finally, the assertion that the church's teaching on contraception has contributed to many deaths is extraordinary. How can the church stand so accused when it proposes the only secure way to avoid AIDS transmission, which is through fidelity in marriage? If the church's ideas were followed, the spread of AIDS would not be the problem we have now. So please, lay the blame for deaths from AIDS on somebody else's doorstep where it belongs.

Jurgita Zemaityte
Brussels

SIR – What kind of religion would change its views to please public opinion? The real issue, in America at least, is that many of us don't like to be told how to live our lives. Being a faithful Christian is not an easy proposition and cannot be made easier simply by softening the edges.

Peter Muehleis
Sheboygan, Wisconsin

SIR – Disagreeing with the church and its late pontiff on policy positions is one thing, but criticising it for being "an undemocratic institution with uncompromising views" demonstrates a misunderstanding of the role of the church. Religions, like constitutions, are by their nature anti-democratic on the basic principle that what is right is not always popular. It is perfectly valid to argue on ethical grounds that the church supports the wrong principles (your argument on condoms and AIDS did this well) but denouncing the church along democratic lines misses its rationale.

Francisco Aguilar
Cambridge, Massachusetts

SIR – In your obituary of John Paul II you say that he used to ski until he was made an archbishop (Obituary, April 9th). Karol Wojtyla was appointed an archbishop in Cracow in 1964 but still continued to ski well into 1993, long after he became pope. When told in the 1970s that it is unbecoming for a cardinal to ski, he joked that it is only unbecoming for a cardinal to ski badly.

Robert Golanski
Warsaw, Poland

Limited sovereignty

SIR – Your survey on consumer power contains a key omission; the effect of government regulation, which has long impinged on consumer sovereignty to protect vested producer interests (April 2nd). I can't imagine it will be long before government regulates the information available to consumers on the internet, to protect us from the "wrong" information. The same issue of your newspaper contained an article about the French, ever the innovators in the use of the dead hand of government, attempting to reign in Google and its scandalous use of popularity rather than "good taste and cultural sophistication" to determine which information is given to consumers ("Google à la française", April 2nd). I now await a story about the United States Congress enacting a bold consumer protection act following successful lawsuits by consumers who buy faulty goods after reading good reviews about them online.

Nick Wills-Johnson
Perth, Australia

SIR – It is correct that it is becoming increasingly difficult to attract consumers' attention. This not only places a premium on targeted, relevant communications, but, more importantly, reinforces the need for retention branding. In other words, the best way to deal with jaded and sophisticated prospects is to do a better job of keeping the customers you've got.

Nick Wreden
Kuala Lumpur, Malaysia

Policing Britain

SIR – In your election-briefing article about crime policies, you incorrectly stated that my party wants to abolish the stop and search form ("Toughing it out", April 9th). In fact, we accepted this recommendation of the Macpherson report; it makes a valuable contribution to race relations in Britain and we do not want to abolish it. The police paperwork we do want to abolish is the political correctness and red tape which keeps officers chained to their desks for almost half of their time instead of out on the street fighting crime. This includes the "stop" form (sometimes called "stop and account") which requires an officer to fill out seven minutes of paperwork every time he stops someone, even if he does not search them. Under this requirement it can take an officer the best part of an hour to confront a group of unruly youths. With such forms, it is little wonder that crime has risen significantly under Mr Blair and that last year, for the first time ever, there were more than a million violent crimes recorded in England and Wales. That is why, within the first day of the next Conservative government, we will file this form in the appropriate in-tray—the bin.

Michael Howard MP
Conservative Party leader
London

Judgment day

SIR – One of the explicit duties of an elected president, as laid out by the United States constitution, is to shape the ideology of the courts by nominating those judges he sees fit to interpret federal law (“Don't go nuclear”, April 2nd). Once these judges are given a hearing and approved in a Senate committee, the rationale for obstructing a vote in the full Senate can only be

viewed as strictly partisan. Every American understands this. When we went to the polls last November, we knew that a vote for George Bush or a vote for John Kerry meant a vote for either conservative judges or liberal judges. This message was prevalent almost every day of the campaign and, along with an ageing Supreme Court, was another reason why the election was so heated. And, unlike 2000, Mr Bush received a mandate this time. If the Republicans do deny the Democrats the filibuster option, they will be finally acting like the majority party—and will allow their party leader to carry out his constitutional obligation to define the judiciary.

Anthony Mendoza
Berea, Kentucky

Battling for business

SIR – You refer to a "lack of hard evidence" in support of Thomas Donohue's claim that prosecutors and regulators have exceeded their authority in their attacks on American businesses (Face value, April 2nd). However, such evidence does exist but it will likely remain hidden in the secret world of *qui tam* lawsuits and "sealed" governmental investigations. Among the reasons such evidence is unavailable is not only that business executives "fear retaliation", as you correctly state, but also because American confidentiality rules and the required privileges attached to legal work simply do not allow those who do know something about this governmental abuse to come forward.

Janet Kaiser
Marina del Rey, California

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Economist.com SPECIAL

South African race relations

If only the adults would behave like the children

Apr 21st 2005 | CAPE TOWN AND JOHANNESBURG
From The Economist print edition

Panos

South Africa has made admirable strides since apartheid was abolished 11 years ago. But the political scene is once again taking on a nastier racial tinge

Get article background

IT FEELS light years away from the era of apartheid, when the bizarre, brutal apparatus—of race classification, separation and enforcement—would stun the visitor on arrival in South Africa, as though he had landed on a strange planet. This correspondent last saw South Africa two decades ago, when the ruling Afrikaners (those of mainly Dutch descent who had conquered the land and its people three centuries ago, wresting power at the polls in 1948 from the whites who spoke English) had begun to agonise over whether to surrender power or to fight on from within their besieged laager. Yet they were still emphatically, deadeningly, in charge. Whites ran everything worth running.

Now, after the miracle of the harmonious handover in 1994, the change in mood remains palpable and still, for the most part, inspiring. The visitor arrives in a country which looks, on the face of things, to be normal in a humdrum multi-racial manner. The bullying and cringeing in public places is mercifully over.

These days in Melville, once a dowdy and largely Afrikaner suburb of Johannesburg but now a fashionably cosmopolitan village of bars, bookshops and internet cafés, young blacks and whites laugh and josh together on Friday nights—more noticeably than in most American cities. In the shopping malls of the posher suburbs farther north, suave young blacks, perhaps children of some of the 25,000-odd dollar millionaires said to have been created since 1994, buy trendy clothes from solicitous white shop assistants. In the nearby playgrounds of the better state schools, black

children play happily with white ones. In the evenings, whites and blacks both chuckle at the strange multi-racial goings-on in “Isidingo”, a television soap saga, one of several set in the social mix of the new South Africa.

For blacks, who make up 79% of the total populace of some 47m, a new sense of freedom still prevails: opinion polls show that they overwhelmingly believe their country is heading the right way and that their lives are getting, or will get, better. The vote for the ruling African National Congress (ANC) has risen steadily in three general elections (1994, 1999 and 2004) from 62% to nearly 70%. For many of the 4.4m whites, comprising under 10% of South Africans, their sense of loss—of power, privilege and to some extent purse—is matched by a more agreeable feeling that they are no longer an oppressive minority to be vilified by the world and hated by many of their compatriots. For the 4.1m coloureds, as mixed-race South Africans still call themselves, and the 1.1m Indians, 9% and 2% of the population respectively, the new order is generally more pleasant, if not entirely so.

The ANC, under President Thabo Mbeki, remains officially wedded to its long-vaunted charter of racial equality. The make-up of his government reflects the rainbow ideal. Six of the 28-strong cabinet are non-black (including three whites), along with ten out of 21 deputy-ministers (of whom six are white). Mr Mbeki seems particularly keen to reach out to embrace Afrikaners, once the blacks' chief oppressors, and bring them into his broad-church ANC. “He [Mbeki] sees Afrikaners as genuinely African people,” says the last white president, F.W. de Klerk, “the English not so much.”

It looks nice but...

Moreover, despite switching huge dollops of cash from the budget to improve poor black people's housing, their supply of electricity and water, and education at the lower end of the scale, the prudent handling of the macroeconomy under the watchful eyes of Trevor Manuel, the finance minister, and Tito Mboweni, the central bank's boss, has been praised even by the wariest of white sceptics. Few whites think they are being squeezed by the taxman until the pips squeak. For most of them, with even middle managers enjoying servants and a swimming pool, South Africa is still extraordinarily cushy.

Yet behind this superficial picture of integration and progress, real as much of it is, all is not rosy. White emigration figures are hard to pin down, because most of those departing do not say that they are going for good. It is likely, however, that 250,000-plus have left since 1994, many of them young and talented. An increasing number of whites, especially those with children, are edgier about pledging themselves to the country's long-term future.

There are three main reasons for this. The first is a growing feeling, sharpened by loudly vaunted schemes that amount to positive discrimination in favour of blacks, that they will not, in the long run, have equal career prospects with their black compatriots, now that the legislative boot is on the other foot.

The second is a growing suspicion that the ANC is not truly committed to a pluralistic, liberal democracy. It increasingly gives the impression that opposition is tantamount to undermining the government's efforts to build a just society—and that people who do not accommodate themselves to the reality of ANC power should somehow be penalised.

The third reason, consequently, is the growing sense of racial polarisation in politics that now threatens to seep into other walks of life. In contrast to his predecessor, Nelson Mandela, who softened the hearts of the harshest Afrikaner racist with his magnanimity and humility, Mr Mbeki has shaken the confidence of many whites with his bitter, racially loaded attacks on those he

deems to be critical of him or his government. In particular, his attacks on the main opposition party, the Democratic Alliance (DA)—now backed by some three-quarters of South Africa's whites and maybe half of its coloureds—and on its white leader, Tony Leon, have been virulent. In the minds of many whites, this virulence departs from the norms of civility in a liberal democracy.

The white spectrum

Still, South Africa's whites are not—and never were—homogeneous in their racial and political attitudes. A third of them, mostly Afrikaners, voted against Mr de Klerk's referendum in 1992 when he, in effect, proposed handing over power to the black majority. Most of these, especially working-class whites, poorer farmers and low-level public servants, including the thousands of policemen and other agents of repression who lost their jobs, may still like to turn the clock back. But they know they can't; they have no power at all, and generally keep quiet.

Many English-speaking whites who seemed content with apartheid at the time (you rarely meet a white person who openly says he or she supported it) have gone into a sort of "internal migration", closing their eyes to the new reality, living behind their high-security walls, paying, if they can afford it, for private security, private medicine, private education and houses in areas where blacks still rarely take up residence. They feel that a simple bargain was struck, and should be kept: the blacks won political power, letting the whites continue to do business as usual.

Then come the more adaptable and go-ahead Afrikaners. Pragmatic, tough and deeply rooted in the country, many have come to terms with the new rulers faster than their English counterparts. Young Afrikaner media and mobile-phone magnates such as Koos Bekker, the driving spirit behind the revamped, once slavishly pro-apartheid Nasionale Pers, which owned many of the most influential newspapers in the apartheid era, now get along with the ANC—and Mr Mbeki—just fine.

Not yet a rainbow

How would you feel if a close relative married someone of another colour?, %

	Approve	Uncertain	Disapprove
Black	53	21	24
White	14	25	59
Coloured	67	19	12
Indian	53	17	29

Source: Institute of Justice and Reconciliation

Big business has also long since made its peace with the ANC. Indeed, it is deeply grateful that Mr Mbeki, and before him Mr Mandela, persuaded the party faithful to ditch their long-held belief in nationalisation and to accept a market economy. Firms such as Anglo American, the mining and manufacturing conglomerate, have happily been co-opted. Many businessmen see the empowerment charters, which, with variations by industry, propose "voluntary" incremental increases in the proportion of blacks in management and—most controversially—in the amount of black-held equity, as a price worth paying, provided the old corporate regime ticks over more or less as before.

The typical transfer of shares—and the issuing of new ones—means that blacks are expected to end up owning at least a quarter of the company by, say, 2010. It's like paying a tariff for a long-term licence, explains the scion of an old mining house. "The cost to the shareholders is usually 2-3%...at the end of the day it's a pretty bloody cheap price to keep up our first-world structure."

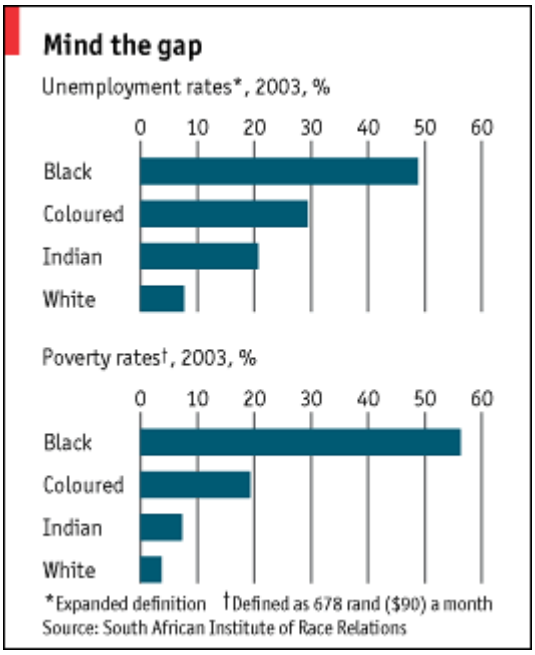
At the far-left end of the white spectrum, only a handful of whites—perhaps as low as 2% — actually support the ANC at the polls. Some have bailed out, thanks to what they see as Mr Mbeki's wrong-headed views on Zimbabwe and/or how to tackle AIDS. But most of them have remained loyal (their more cynical fellow whites tend to dub them "ANC groupies"), turning a blind eye to Mr Mbeki's peculiarities, in order to display solidarity with the hallowed cause of "transformation".

The most unhappy whites, in politics, are undoubtedly the liberals, including Mr Leon and his party's indomitable 87-year-old icon, Helen Suzman, who for many years was a lone voice of dissent in the apartheid-era parliament but who now roundly criticises the ANC from a liberal standpoint. Such people, and most of the DA's leading lights, consistently fought against apartheid in the hope of replacing it with a non-racial, tolerant, pluralistic but individualistic society. It is the bitter polarisation between white liberals and the ANC that is making race relations look ugly again, especially since the ANC's strong Africanist element sees the country as essentially one run by blacks, with whites, if they wish to join in, adapting to African cultural and political traditions.

Still a liberation movement

In key respects, the two groups stand for quite distinct values. For sure, the ANC is a big tent. “We are very mixed,” says Sue van der Merwe, a deputy foreign minister who has worked closely with Mr Mbeki. “We have neo-liberals and Marxists but mainly we're social democrats.” But the party's deepest instincts still derive from its many years as a liberation movement in exile. “Unity is all,” says a former activist. The ANC's party discipline is still often ferociously enforced, as it was during those long years of conspiratorial politics, when Leninist centralism prevailed and the Soviet Union was the movement's chief ally.

With its recent strong popular endorsement at the polls, the ANC, which looks set to hold power for the foreseeable future, is gradually conflating, in its collective mind, the interests of party and state. As elsewhere in Africa in the past, there is little concept of a loyal opposition. As Archbishop Desmond Tutu has said, “a culture of sycophancy” has grown up around the president, who scolded the prelate in vitriolic terms for his temerity in speaking out.



Among thoughtful members of the ANC, there is a sort of struggle between head and heart. In their heads, they accept a separation of powers, the independence of the judiciary and the media, the importance of a freestanding civil society, and the rights of the parliamentary opposition to oppose. The party has not sought to tamper with the highly liberal post-apartheid constitution. “It defines an arms-length relationship between the institutions and the executive,” says Joel Netshitenzhe, a close aide to Mr Mbeki, approvingly.

But in their hearts, the desire for the kind of one-party state—in spirit if not in constitutional writ—that virtually all their fellow-liberation counterparts achieved elsewhere in Africa remains strong. The same Mr Netshitenzhe, writing in an ANC journal during the party's first term in office, declared that “the transformation of the state entails, first and foremost, extending the power of the National Liberation Movement over all the levers of power: the army, the police, the bureaucracy, intelligence structures, the judiciary, parastatals, and agencies such as regulatory bodies, the public broadcaster, the central bank, and so on.” He may have changed his mind. Many of his colleagues have not.

Given the size of the ANC's majority in parliament, it is perhaps not surprising that the government appears to put such little stock in debates in the chamber. The party-list system (opposed by the liberals) means that ANC dissenters tend to get quickly pushed out. Private members' bills are very rare. Mr Leon's party, though the second largest, has only 50 out of 400

seats to the ANC's 285.

Mr Mbeki reserves his most biting contempt for Mr Leon and his social and economic liberals. The ANC, says Mr Leon, has referred to him repeatedly as a racist, a neo-Nazi, a Zionist, a crook and, in Mr Mbeki's dismissive words, “that white man who chooses to practice his craft in South Africa.” The most depressing phenomenon, in the DA's view, is that, again and again, any criticism of ANC policies is met with accusations of racism.

The DA's criticism of the ANC's policy of black empowerment and its drive towards “representivity” across the board (the aim that the racial composition of every outfit, whether a school or a business or a national sports team, should eventually be in proportion to the country's overall racial profile) is poisoning the atmosphere. The DA thinks that job allocations should not be classified by race. It fears that economic empowerment has meant white tycoons handing over slabs of equity to a handful of black tycoons without benefiting the masses of poverty-stricken blacks, more than 40% of whom are jobless (against 8% of whites), and more than 50% of whom live in poverty.

Reuters

Thabo and Tony: no love lost

Instead, the emphasis, according to the DA, should be on growth, education, deregulation and a freer labour market. “Race entitlement is being legitimised again,” sighs Frederick van Zyl Slabbert, who led the liberal forerunner of the DA in the 1980s. “Unfortunately race is again being built into a whole range of activities.”

The liberals tend to decry the willingness of big business to co-operate with the ANC. “Anglo licks the ANC's boots,” says Mrs Suzman, referring to the country's premier company. The big corporations are “so scared of government, they just crawl under the table,” says Mr Leon. Black editors as well as white ones are vilified if they dissent, often with the charge that they are defending white privilege.

Cool it, Tony, you're embarrassing us

The more pragmatic whites, who think it wiser to go with the flow, think Mr Leon, a brave, clever and ebullient lawyer who would revel in the hurly-burly of parliamentary debate in a western democracy, far too adversarial. True, he heads the opposition. But his attitude goes against the idea that “we're all in this new project together”, as a wary white editor puts it. They think he is unduly derisive of the government. Though in an ideal world it would be nice if qualified and talented blacks gradually worked their way up through the ranks of whatever profession they are in, it would be politically ludicrous, say the pragmatists, for Mr Mbeki not to be taking drastic and immediate steps to ensure that they are better represented, especially at the top. Moreover, bluntly speaking, the DA would be more credible if it were led by a black man.

Apart from black empowerment, two other policies of Mr Mbeki have further fanned the flames of racial animosity: Zimbabwe and AIDS. On both scores, the liberals put the blame largely on the president. Various explanations for his refusal to censure Robert Mugabe have been floated, but racial solidarity—shared, in any case, by most other leaders in southern Africa—is one of the most plausible.

A curious way to define a plague

On AIDS, Mr Mbeki's attitude seems even more puzzling—and has sharpened racial animosity still more. Though his government is belatedly implementing a plan to dish out anti-retroviral drugs, it still woefully lacks a sense of urgency. Meanwhile, 1.5m South Africans have probably died of the scourge, and at least 5m are thought to be infected with HIV, one of the highest rates in the world.

What is plain, in any event, is that Mr Mbeki sees attacks on his attitude (for refusing, at least initially, to accept a causal link between HIV and AIDS) as racially driven and implying—among other things—a contempt for black men. In an outburst in parliament, he accused “certain people” (meaning anti-rape campaigners and the DA) of propagating stereotypes of black men as “rampant sexual beasts, unable to control our urges, unable to keep our legs crossed, unable to keep it in our pants”.

Such “racial prickliness” (to use the archbishop's words) does little for race relations. Arguably, Mr Mbeki may feel he has to echo the widely shared sentiments of his black compatriots, their sense of anger and frustration that so many of them are still living in dire poverty as they were under apartheid, while the white minority still has it so good.

For, despite the impressive strides towards integration at the top of the pile (however skewed, in liberal eyes, that process, has been), South Africa is still two countries: a first-world one of comfort and plenty, and a far bigger third-world one of poverty and disease.

Both white liberals and ANC Africanists agree that the two must meet and, one day, merge in prosperity. The booming black middle class provides a useful bridge. But disagreement over the methods of achieving a better life for the poor are sharp. The shame is that these disagreements are being increasingly drawn in terms of racial antagonism.

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China-bashing and trade

Putting up the barricades

Apr 21st 2005 | WASHINGTON, DC
From The Economist print edition

Is Congress turning protectionist?

Get article background

THESE are not happy times for the dwindling band of free-traders in Washington, DC. Trade sceptics are on the move on two fronts: raising the barricades against the Chinese and refusing to lower them for the Central Americans.

Politicians blame China and its fixed exchange-rate regime for America's trade deficit. But Congress is also sceptical about the Central American Free Trade Agreement. Although CAFTA is small beans in economic terms, failure to get it through would spell ill for any global trade deal at the World Trade Organisation (WTO).

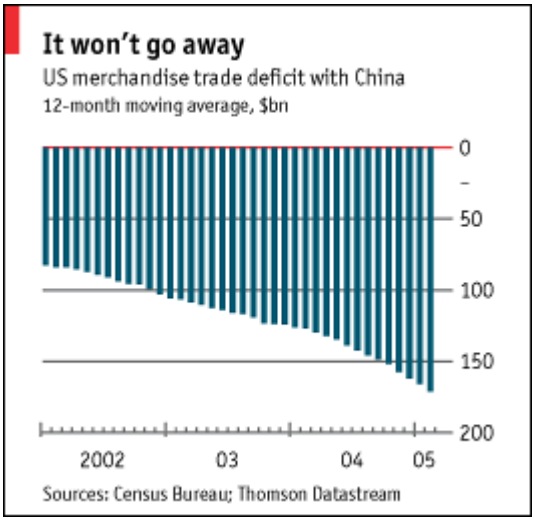
China-bashing has captured the headlines. On April 6th, 67 senators voted against dumping a bill proposed by Charles Schumer, a Democrat from New York, that would impose a 27.5% tariff on all goods from China unless Beijing adjusted its currency within six months. Not only is the legislation utterly against WTO rules, it would cause havoc for the American economy. But Mr Schumer has been promised a vote by July, and his bill may well pass the Senate.

The Schumer bill's success, which has surprised even its sponsor, is accelerating other measures. Two more senators, Susan Collins and Evan Bayh, are touting the Stopping Overseas Subsidies Act, which would allow American firms to get countervailing duties to make up for Chinese subsidies, including a subsidised exchange rate. China is not currently subject to America's anti-subsidy law as it is deemed a “non-market economy” (which makes it easier for American firms to

file anti-dumping cases against it). But declaring China a market economy for the purposes of subsidies, and a non-market economy for the purposes of anti-dumping, is against WTO rules.

Nobody in Congress, alas, seems to care about breaking WTO rules. The aim is to be seen to be bashing China loudly. Mr Bayh is holding up the confirmation of Rob Portman, the new trade representative, until his bill is voted on. Meanwhile, in the House of Representatives, Duncan Hunter, a conservative Republican, and Tim Ryan, a Democrat, have cooked up a law that allows American companies to use “exchange-rate manipulation” as a reason for demanding protection under America's trade laws. And the Congressional China Currency Action Coalition has filed a Section 301 petition asking the Bush administration to file a formal case to the WTO complaining about the yuan.

In the 1980s, a rising trade deficit—at that time with Japan—fuelled protectionist pressure in Congress. Ronald Reagan introduced the notorious “voluntary export restraints” on Japanese steel and cars. The Reagan team also abandoned its laisser-faire attitude to currency markets and, through the Plaza Agreement, engineered a sharp drop in the dollar.



The current bout of China-bashing is not a replay of the 1980s. Back then, large American firms, particularly the Detroit car giants, led the clamour for protection. Now big business, which relies heavily on Chinese inputs, is quieter. The shouting comes from smaller American suppliers. And even the noisier business groups, such as the National Association of Manufacturers, are relatively nuanced. Though the NAM wants Beijing to revalue the yuan, it does not support the Schumer bill.

Less encouragingly, the political and economic risks are bigger this time round. In the 1980s Japan, for all its faults, was always viewed as a democratic ally in Asia. By contrast, China is now seen as a nasty communist regime and a dangerous rival. In the mid-1980s, America's current-account deficit was smaller, 3.5% of GDP in 1985 compared with 6.3% today, and its debt stock lower. Today, America is the world's biggest debtor, with China as an important creditor. A sharp reversal in China's appetite for American Treasury bonds could send interest rates soaring.

For now, the Bush administration seems to be trying to muddle through. It has increased its rhetoric about the need for China to fix its exchange rate. It said this at the G7 meeting of finance ministers on April 16th, and, when the Treasury issues its twice-yearly report on currencies later this month, it is likely to come close to calling China a “currency manipulator”—a term last applied to Beijing in 1994.

The Bush team hopes to keep this grandstanding to a minimum. But the China-bashing in Congress presents a danger. At worst, this frenzy could result in a series of illegal (in WTO terms at least) protectionist bills becoming law. Even if things do not get that far, the China effect will complicate an already tough struggle to get CAFTA through.

Aside from a handful of ardent free-traders, Democrats are solidly opposed to the Central American trade deal, thanks largely to a massive lobbying campaign by the unions. The unions believe (correctly) that if CAFTA is defeated, Mr Bush's trade agenda will lie in tatters. In the face of determined union opposition, Mr Bush is already having trouble persuading many Democrats. Alarmist news about imports from China makes this task much harder.

Another set of CAFTA sceptics—the textile lobby—ought to be brought on board by fears of China. The Central American agreement is in part a way of staving off Chinese textile imports, which have surged since the quota regime ended this January. Without CAFTA, Central America's textile industry is likely to be decimated by Chinese competition. With the special duty-free access that CAFTA grants, Central American textile firms—and the American companies that supply them with material—may survive.

The Bush team is busy making this argument to textile groups. But the opposition against free trade of any sort in hard-hit textile states like the Carolinas is considerable (see article). The White House is thus getting more overt with its bribes, such as its decision to consider safeguard quotas against Chinese imports for several textile products.

Another powerful southern lobby, the sugar industry, is proving even harder to placate. Outrageous import quotas keep the domestic price of sugar at double that of the world price. CAFTA would allow more imports in from Central American countries, but still less than 2% of US sugar production. For the sugar lobby—and the 15 or so Republican politicians who follow its bidding—that is still too much.

The betting is that, with enough presidential involvement and vote buying, Mr Bush may get CAFTA through in the next couple of months. Until he does, there will be little appetite in the White House to give the China-bashing in Congress the cold shoulder that it deserves.

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North Carolina

The human cost of cheaper towels

Apr 21st 2005 | KANNAPOLIS
From The Economist print edition

A town struggles to cope with laid-off textile workers

AP

The lure of protectionism

KANNAPOLIS was once a company town. James Cannon, a textile tycoon, founded it in 1906 so that he could keep a paternalistic eye on his workers. During the Depression, his son—the beloved "Old Mr Cannon"—looked after his people and built them tiny white houses. Good wages, free electricity and the promise of a secure job tied each generation to Cannon Mills.

But the textile giant, which used to produce 300,000 towels a day, could not fight off cheap imports or indeed the march of technology. On July 30th 2003, Pillowtex, the last in a string of owners, closed all 16 of its American factories, throwing nearly 6,500 people out of work. It remains the largest single-day job loss in North Carolina's history; in the Kannapolis area alone, 4,300 people lost their jobs.

Today, the old mills are gutted and ready for demolition. And most of the workers are still puzzling over what to do. Over the past decade, North Carolina has lost 250,000 manufacturing jobs (90,000 in textiles). With textile quotas now having been phased out, still more jobs will go.

North Carolina's technology and service sectors are booming. But many mill workers are woefully ill-prepared for such work. When Pillowtex finally closed the doors, one in three of its workers lacked a high-school education; one in ten could not read or write; and nearly half of them were more than 50 years old.

An established federal programme, Trade Adjustment Assistance, provides fairly generous income support for such workers while they are being retrained. In 2002, Congress stretched these benefits from 78 to 104 weeks. But the Pillowtex closing is so vast that it is testing the programme's effectiveness. "Never have we had so many who had worked for so long at one place lose their jobs," says Linda Burton, a 30-year veteran of the Employment Security Commission, the state agency that helps workers find jobs.

Nearly 2,000 of the workers signed up to retrain. Many of them had not set foot in a classroom for several decades. "I didn't know how to use a calculator," admits Jerry Kennerly, a 58-year-old who is studying to pass the high-school equivalency test. "I had to relearn algebra." They keep their morale up with tales of heroic feats: the woman who jumped from a seven-year-old to a 12-year-old reading level in one year; the 70-year-old man who passed his high-school equivalency exam. But it is tough. "If I don't learn computers," says Mr Kennerly, "I'm going to be behind."

The true test will come in December when the first big group of worker-graduates starts hunting

for jobs. Many of the older ones want to stay in Kannapolis, which is hardly booming nowadays. And there are plenty more who are not even close to getting the training. Some are languishing in remedial courses, unable to get to the 12-year-old reading level that they need to enter a job-training course. The mill employed quite a number of mentally or physically disabled people to sweep the floors. They are struggling the most, says Ms Burton. “We are hoping companies will have a heart.”

The group of workers that may actually gain most from the training are foreigners. So long as they could prove they were legally in the country, several hundred Laotian and Latino workers qualified for training. Scores of poor immigrants who never dreamed of being much more than manual labourers are now getting a free education. Crucially, unlike the locals, they feel fewer ties to Kannapolis and so will take their new skills anywhere.

Ying Xiong, a 38-year-old Laotian woman who worked as a weaver, is now learning English and computers. She hopes to become a medical-unit secretary. She reckons this is a safe bet, as Americans will never ship their health care overseas. Old Mr Cannon's workers once probably felt the same way.

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Conservatives v the judiciary

Judge yourself

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The battle over George Bush's judicial nominations reflects deep right-wing unrest. It could become one of America's most important political fights for years

AMERICA is a nation of laws (and lawyers). Questions that in other countries are addressed by parliaments are frequently delegated to the courts. Respecting the independence of the judiciary is a canon of American politics. So it is somewhat shocking to find conservatives hurling references to Stalin and the Ku Klux Klan into a dispute over judges.

“Stalin had a slogan, and it worked very well for him, whenever he ran into difficulty: ‘no man, no problem'...We are in this mess because we have the wrong people as judges.” That was a lawyer, Edwin Vieira, addressing a conference on “Confronting the judicial war on faith”.

“I heard a minister the other day talking about the great injustice and evil of the men in white robes, the Ku Klux Klan ...and they did great wrong to civil rights and to morality. And now we have black-robed men and that's what you're talking about.” That was Jim Dobson, head of Focus on the Family, arguably America's most powerful evangelical organisation.

“The filibuster [a parliamentary technique that the Democrats are using to prevent confirmation of George Bush's judicial nominees] was once abused to protect racial bias and it is now being used against people of faith.” That is from a flyer for a call-in programme this Sunday organised by another conservative group, the Family Research Council.

Such strident noises are coming from within Congress too. The Republicans' leader in the Senate, Bill Frist, will take part in the Family Research Council's call-in. Tom DeLay, the majority leader in the House, has warned: “We [Congress] set up the courts. We can unseat the courts.” During the fury over Terri Schiavo, he said that “the time will come for the [judges] responsible for this to answer for their behaviour.” His footsoldiers talk about cutting the budget for the federal bench and even impeaching judges, including Supreme Justice Anthony Kennedy.

It must be said right away that not every American conservative shares this enthusiasm for assaulting the judiciary. Most importantly, Mr Bush does not. “I believe in an independent judiciary,” he said recently. Dick Cheney added that, although he disagreed with various judicial decisions, “there's a reason why judges get lifetime appointments.”

It is also fair to point out that attacks on judges are as old as America itself. In 1805, Jefferson's supporters impeached Justice Samuel Chase basically for being a member of the opposing party (Chase was acquitted). Current calls to “impeach Justice Kennedy” echo demands to “impeach Earl Warren”, chief justice in 1953-69.

But several things make this outbreak of judge-baiting different. For one thing, the rhetoric comes with threats of action, such as impeachment or financial penalties. For another, the range of hostile opinion seems unusually wide, from moralists, to business lobbies, to libertarians, to constitutional purists.

Perhaps the biggest difference is that in the past critics have focused on individuals (like Justice Warren). The target now seems to be the judiciary as a whole. Conservatives talk of mass impeachment. Bills have been introduced restricting courts from hearing certain kinds of legal challenge, for example to the Defence of Marriage Act. Congressman Steve King of Iowa has reminded people that “we have the constitutional authority to eliminate any and all inferior courts” (which is true, though one wonders why he should feel the need to point it out).

Two congressional battles loom. War is already under way over the question of Mr Bush's judicial nominations, which conservatives say have been blocked unfairly by Democrats; some Republicans now want to invoke “the nuclear option” and change Congress's rules to stop their opponents filibustering the nominees. That struggle, though, would pale alongside the war brewing if Mr Bush has to nominate somebody to the Supreme Court. Several justices, including Chief Justice William Rehnquist, are ailing.

What is behind the barrage of legal criticism from the right? And why is it growing now? It may seem surprising that conservatives should be in a bate when the courts are friendlier towards them than for 50 years. The Rehnquist court has struck down no fewer than 33 federal laws on constitutional grounds, amounting to the tightest restraint on the power of the federal government since the 1930s. It has consistently supported states against federal authority. It ruled in favour of the current president in *Bush v Gore*. One can hardly see it as a left-wing cabal.

Lower down the judicial ladder, Republican appointees outnumber Democratic ones in ten of the country's 13 circuit courts and account for 94 of the 162 active appeals court judges. To deepen the conservative flavour, Mr Bush has stopped having his nominees initially vetted by the American Bar Association and switched to the more ideological Federalist Society.

So why are conservatives frustrated? The immediate causes are varied, and include the ruling to legalise gay marriage by the Massachusetts Supreme Court as well as the Schiavo case and Mr Bush's difficulties in getting his judicial nominees confirmed. But even without these prompts, conservatives would still be frustrated for two reasons.

First, although the Supreme Court has been conservative on the disposition of state and federal power, it has not been so (at least to conservatives) on moral concerns. In 1992 the court reaffirmed both the right to abortion and a ban on prayer in public schools. This year, the court struck down the death penalty for juvenile offenders (adding insult to injury, the majority cited international law to support its opinion). Most important, in 2003 the court struck down Texas's anti-sodomy law on the grounds that people have a constitutional right to consensual private behaviour. The majority went out of its way to deny that this made gay marriage inevitable, but Justice Antonin Scalia wrote in a dissent, “do not believe it”.

Second, conservatives argue that, though many of their concerns go back years, the courts are now much clearer obstacles than ever. Until the Bush presidency, the main problem was political: Republicans did not control the presidency and Congress. During the Reagan period, when they were ascendant, they hoped to bring the courts round to their way of thinking gently. In their view, this did not happen. Now that they are in the ascendant again, they have to be tougher.

Considering the range of concerns to which they are responding, it is not surprising that proponents of conservative legal reform are themselves something of a mixed bag. At least four different strands can be discerned.

• Those who make the most noise are the **moralists**. For the most part, they are church leaders and conservative activists, not lawyers. They worry less about legal processes than outcomes, such as the Schiavo and gay-marriage decisions. But they have support among some legal scholars, such as Robert George, a professor of jurisprudence at Princeton, who argues that

decisions such as the Texas sodomy case “do not vindicate principles of equality. Rather, they impose a particular set of cultural leftist doctrines about the nature, meaning and moral significance of sexuality and marriage.”

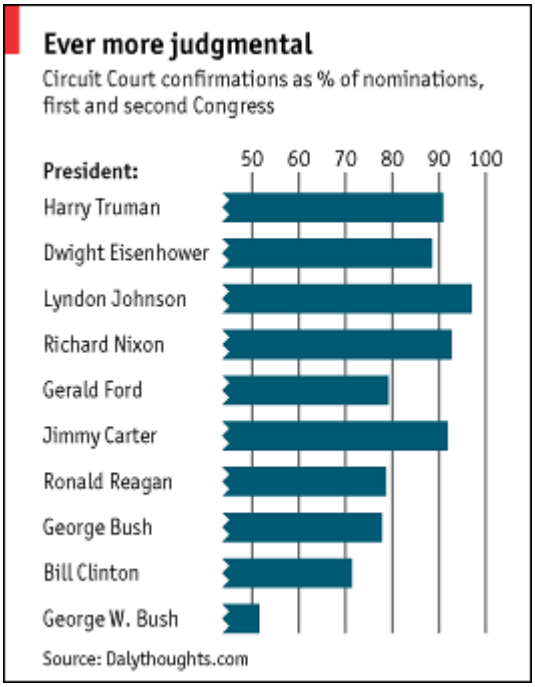
• The **business lobby** is mainly concerned with the costs of regulation and product-liability suits. Since much of state product-liability law comes from precedent and from judicial rulings, not statute and legislators, businesses blame judges for what they see as bad tort law and are every bit as enthusiastic as moralists to get “the right kind of judge” on the bench. The National Association of Manufacturers is planning to spend millions on advertisements backing President Bush's judicial nominees.

• The other two groups provide the intellectual heft to these lobbyists. “**Originalists**” argue that the constitution is not a living document, to be interpreted in the light of changing circumstances, but a fixed one to be interpreted according to its original meaning. Originalists, of whom the best known is Justice Scalia, are sceptical of rights that do not appear explicitly in the constitution (such as the right to privacy). In that respect, they differ from the Rehnquist court. But they are similar to it in showing deference to legislatures and their enthusiasm for states' rights.

• The last group goes further. **Property rightists**, as they might be called, share the originalists' hostility to rights not explicit in the constitution. But the group, whose best known figure is Richard Epstein, a law professor at the University of Chicago, says there is one right to which courts pay too little attention: private property. From their perspective, the minimum-wage law, the Environmental Protection Agency and Federal Communications Commission all ought to be scrapped as unconstitutional. The property rightists, who are also less deferential than originalists to state legislatures, are popular among business groups.

One legal team

These four groups overlap. They are united on the type of judge they want: people who view the constitution as a static document. And they form a fearsome combination behind that aim, uniting moral and corporate lobbying power with intellectual conviction.



The strength of this alliance will be tested in the next few weeks over the Democrats' use of the filibuster to hold up Mr Bush's judicial nominees in the Senate. The Democrats cite overall numbers that prove they are blocking Mr Bush's judges at roughly the same rate as the Republicans stopped Mr Clinton's. Conservatives say that the Democrats are being unusually obstructive when it comes to the more important circuit judges (see chart).

Under Senate rules, it takes 60 votes to break a filibuster, and Republicans have only 55 seats. But you can change Senate rules with 51 votes. Mr Frist has threatened to use the nuclear option to change that rule for judicial nominees. That could fundamentally alter the deliberative proceedings of the Senate. It is unclear whether Mr Frist will risk this (Senator John McCain opposes the idea and several other Republicans are wobbling). But the conservative legal juggernaut makes any compromise hard to reach.

Meanwhile, the first skirmishes have begun in the coming war over a possible Supreme Court

nomination. Several judges on Mr Bush's alleged shortlist, including Michael Luttig and Michael McConnell, have links with the property rightists. The Supreme Court could mobilise the whole conservative legal coalition behind an effort to change the basic fabric of American law, with Democrats firing back just as fiercely.

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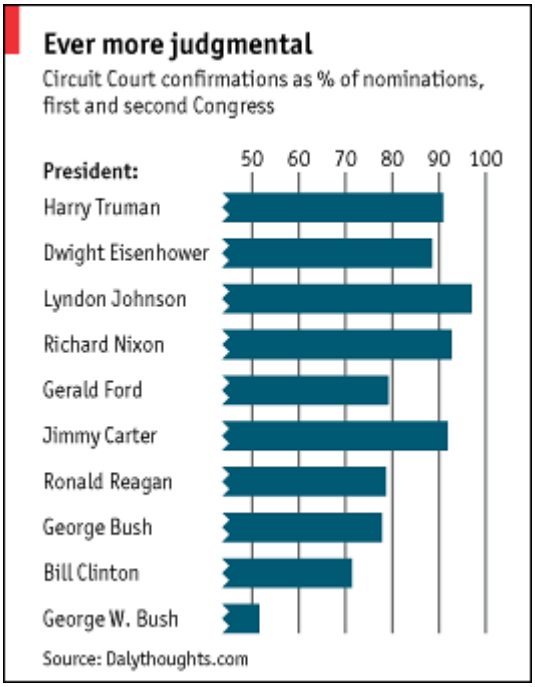
• The last group goes further. **Property rightists**, as they might be called, share the originalists' hostility to rights not explicit in the constitution. But the group, whose best known figure is Richard Epstein, a law professor at the University of Chicago, says there is one right to which courts pay too little attention: private property. From their perspective, the minimum-wage law, the Environmental Protection Agency and Federal Communications Commission all ought to be scrapped as unconstitutional. The property rightists, who are also less deferential than originalists to state legislatures, are popular among business groups.

One legal team

These four groups overlap. They are united on the type of judge they want: people who view the constitution as a static document. And they form a fearsome combination behind that aim, uniting moral and corporate lobbying power with intellectual conviction.



The strength of this alliance will be tested in the next few weeks over the Democrats' use of the filibuster to hold up Mr Bush's judicial nominees in the Senate. The Democrats cite overall numbers that prove they are blocking Mr Bush's judges at roughly the same rate as the Republicans stopped Mr Clinton's. Conservatives say that the Democrats are being unusually obstructive when it comes to the more important circuit judges (see chart).

Under Senate rules, it takes 60 votes to break a filibuster, and Republicans have only 55 seats. But you can change Senate rules with 51 votes. Mr Frist has threatened to use the nuclear option to change that rule for judicial nominees. That could fundamentally alter the deliberative proceedings of the Senate. It is unclear whether Mr Frist will risk this (Senator John McCain opposes the idea and several other Republicans are wobbling). But the conservative legal juggernaut makes any compromise hard to reach.

Meanwhile, the first skirmishes have begun in the coming war over a possible Supreme Court

nomination. Several judges on Mr Bush's alleged shortlist, including Michael Luttig and Michael McConnell, have links with the property rightists. The Supreme Court could mobilise the whole conservative legal coalition behind an effort to change the basic fabric of American law, with Democrats firing back just as fiercely.

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Amtrak's woes

The end of the line?

Apr 21st 2005 | WASHINGTON, DC
From The Economist print edition

It should finally be in sight. But don't count on it

Getty Images

But when will it leave?

JUST five years ago, Amtrak, America's struggling passenger rail-service, pinned its hopes on a new high-speed train to cure its woes. At a speed of 150mph (240kph), its new Acela trains would make the trip from New York to Washington, DC, in under three hours. Passengers driven away by the firm's lousy service would return in droves—and Amtrak would at last turn a profit.

Last week, a routine inspection found cracks in 300 brake discs in the Acela fleet. All 20 trains were abruptly yanked from service. It could be some time before they are up and running again: Bombardier, which makes the discs, has only 80 in stock. Lost ticket sales are mounting fast.

The timing could not be worse. Back in February, the Bush administration deleted Amtrak's operating subsidy, currently $1.2 billion, from its 2006 budget. Now it has sent legislation to Congress that would privatise Amtrak and force it to compete with other private rail lines for contracts doled out by the states. Under the plan, the rails and stations in the north-east corridor, the 450 miles of track extending from Boston to Washington, would be turned over to a federal-state consortium.

It is not hard to think of reasons to kill off Amtrak. In 34 profligate years, it has burned up $29 billion in federal subsidies. And yet there are few passengers—just 25.1m in 2004, up slightly from 22.5m in 2000. The vaunted Acela train arrives on schedule only three-quarters of the time and has had several glitches, including toilet doors that spontaneously fly open.

The Amtrak Reform Act of 1997 supposedly obliged Amtrak to break even in five years; but Congress gave up that hope after four years when it plainly was not about to happen. Cash crunches arrive more often than the trains do. In 2001, the company mortgaged part of New York's Penn Station, generating 16 years of debt payments to get through a three-month cash shortfall. In 2002, it borrowed $100m from the Department of Transportation.

The Bush administration may well be bluffing. It does not really want to take away Amtrak's monopoly, just put pressure on it to reform. Amtrak's Bush-appointed board will unveil its own

reform plan shortly, which will actually ask for even more federal money in order to make huge capital investments in track and so on (which admittedly are direly needed).

Why should the taxpayer swallow this hard-luck story? In the past, Amtrak has proved a surprisingly punchy political fighter. Senators from the states it serves sign up for fear of offending commuters. There is also a vociferous bunch of railway fans, even some coming from places where the service barely exists, who besiege congressmen with letters to save the Iron Horse for future generations. “These hobbyists,” laments Ron Utt of the conservative Heritage Foundation, “are what drives Amtrak”.

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Last night of the proms

Summer nights, drifting away

Apr 21st 2005 | BRYANT, ARKANSAS
From The Economist print edition

Well, they might if you have the right ID

PROMS are an American tradition, conjuring visions of carefree high-school students donning ball dresses and tuxedos and dancing the night away. Or that was the idea before the lawyers, bureaucrats and moralists became involved.

Students attending this weekend's Bryant High School prom might find it easier to sneak aboard a passenger jet. When the young folk from this relatively sleepy Arkansas town bought advance tickets for the dance, they signed a contract acknowledging the school rules prohibiting alcohol consumption. They also had to supply their dates' names, addresses, grade levels and telephone numbers. Identities will be rechecked at the festivities (heaven knows what will happen to any teens bold enough to dump their dates in the closing days). Oh, and the deviant revellers have also had to agree to on-the-spot searches and sobriety tests.

Some of the grittier urban schools have always had rules about things like guns and knives. But proms at less dangerous schools are also more and more rule-bound. One reason is the increase in teen drinking and the activities of groups like Mothers Against Drunk Driving. But rules of all sorts are increasing. Some schools, for instance, forbid public displays of affection.

The awkward thing is that teens do not always obey rules, especially when there are dates to impress. Spiking punch and carrying flasks to dances are old tricks. There is also a fear that some of the stricter rules designed to ban even slightly tipsy behaviour may prove counter-productive. Many of the worst incidents have happened when teens have abandoned the stodgy school-sponsored prom for unsupervised parties in hotel rooms.

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Economist.com WORLD NORTH AMERICA

The battle for the black vote

Rebuilding the party of Lincoln

Apr 21st 2005
From The Economist print edition

The Republicans and blacks: the journey from Honest Abe to Condi

NEARLY 40 years ago Richard Nixon's Republican Party embarked on a “southern strategy” that shifted white southerners from the Democratic to the Republican column, thereby turning American politics upside down. Now George Bush's Republicans are engaged in a strategy that could have equally dramatic consequences—repairing their relations with black America and ridding their party of its odour of racism.

Mr Bush's commitment to winning the black vote is one of the most consistent themes of his presidency. In his first term he not only gave blacks more high-profile cabinet positions than any previous president, including the diversity-obsessed Bill Clinton; he also made sure that he seldom appeared in public unless accompanied by faces of many colours. The reward in last November's election was hardly spectacular—a two-point boost in his vote among blacks to 11%—but since returning to the White House Mr Bush has intensified his wooing.

The Republicans are suddenly mentioning Abraham Lincoln a lot. In his second inaugural address Mr Bush quoted Lincoln on the evils of slavery and compared the struggle for democracy in the Middle East with America's own struggle for a “union based on liberty”. A bust of the great man sits in the Oval Office. Condoleezza Rice mentioned both Lincoln and Frederick Douglass, a former slave who became a stalwart Republican, when she took the oath of office as Mr Bush's second black secretary of state. There is even a “2005 Republican freedom calendar”, replete with references to the party's contributions to civil rights (for instance, Martin Luther King voted for Eisenhower in 1956).

Mr Bush has made a point of inviting leading black figures, particularly religious leaders, to the White House. He has nominated his wife to run a new $150m programme to battle gangs. Ken Mehlman, the Republicans' new chairman, is also on a charm offensive, meeting black leaders and fine-tuning the party's message machine. As with last year's presidential election, the idea is to circumvent both the much loathed “liberal Washington media establishment” and the Democratic civil-rights establishment, and talk directly to black communities about things like Social Security reform.

Why on earth are the Republicans devoting so much effort to a group that is losing its place as America's largest minority to Latinos? Part of the reason is simple arithmetic. The Republicans will dramatically improve their electoral chances—particularly in the mid-west—if they can eat into the Democratic Party's most loyal constituency. By increasing his share of the black vote in Ohio from 9% in 2000 to 16% in 2004, for example, Mr Bush may have boosted his margin of victory by as much as 50,000 votes.

But an even more important reason lies with morality. For the past 40 years the Democratic Party's identification with black causes has given it a virtuous sheen with plenty of moderate voters of all colours (by contrast, Nixon's southern strategy is something many non-southern Republicans would rather not talk about in public). Loosen the Democrat grip on the black vote and this sheen fades; and that, in turn, makes all sorts of things possible, from further inroads into the white vote (white women are a particular target) to a more sympathetic consideration for Republican market-based solutions to urban problems.

Rice with everything

What are the Republican's chances of success? There is no doubt that they are batting on a sticky wicket. One in five House Democrats are black; no Republicans are. The civil-rights establishment is a wholly owned subsidiary of the Democratic Party. “A crazed swarm of right-wing locusts” is the chairman of the NAACP's view on the would-be heirs of Lincoln.

The Republicans nevertheless have three important things going for them. The first is generational change. Young blacks are more willing than their parents to question the Democratic establishment's received wisdom. They are much keener on school vouchers, much keener on entrepreneurship, and much less beholden to the civil-rights establishment, as anyone who has seen the film “Barbershop” might have noticed.

The second is the long-standing cultural conservatism of the black community. Blacks are one of the most religious groups in America. Many are incensed about gay America's attempt to wrap itself in the mantle of civil rights. One video doing the rounds in black churches features lurid descriptions of gay-sex acts and footage of frolicking gay activists, some of them not entirely fully clothed, invoking Martin Luther King's sacred name.

Mr Bush seems to be doing quite well with black clergy. Black preachers played a vital role in mobilising their congregations against gay marriage last November (Mr Bush would not have done as well as he did in Ohio without their support). But many of them support a much broader agenda: the last few months have seen black conservatives launch two “black contracts with America” that include support for faith-based policies and Social Security reform. The Republicans have already built up a conservative counter-establishment to challenge liberals in government and academia; now they want to create a conservative black counter-establishment to balance the liberal civil-rights establishment as well.

The third reason has seldom been far from Mr Bush's side since he decided to run for the presidency. Ms Rice has been steadily accumulating experience and raising her profile, first as

national security adviser and now as secretary of state. In a presidency where the talk will soon turn to succession, she is gradually becoming one of her party's main draws. If the Republicans can put a black woman from segregated Alabama on the ticket in 2008, it will not only give black politics its biggest shake-up for 40 years; it will also provide an appropriate ending to the Republican Party's southern strategy.

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Economist.com WORLD LATIN AMERICA

Fragile states in the Andes (1)

A coup by Congress and the street

Apr 21st 2005 | QUITO
From The Economist print edition

Reuters

Democracy is under strain in several Andean countries. We report from Ecuador, where the president has been overthrown; and from protest-racked Bolivia

Get article background

IT WAS intended as a bold statement of authority, but it merely showed how desperate the position of Ecuador's president, Lucio Gutiérrez, had become. On April 15th, Mr Gutiérrez, flanked by armed forces' commanders, announced that he was dissolving the Supreme Court—for the second time in four months—and imposing a state of emergency in Quito, the capital. In defiance, several thousand protesters immediately took to the streets, calling for Mr Gutiérrez to be sent packing too.

As the army sat on its hands, within hours the president was forced to lift the emergency. Each day the demonstrations, led by Quito's middle class, swelled; two people were killed. On April 20th, Congress heeded the clamour on the streets: 60 of its 100 members voted for an Orwellian resolution which accused Mr Gutiérrez of “abandoning his post” and appointed in his place the vice-president, Alfredo Palacio. To the end, the president insisted he would not step down. But the police chief resigned, saying he would not repress the people. Finally, the army hustled Mr Gutiérrez out of the presidential palace. He took refuge in the Brazilian embassy as an arrest warrant was issued against him.

Thus ended a battle for power, and for control of the courts, between a heavy-handed and unpopular—but legitimately elected—president and the rapacious clans that dominate the country's Congress. Since his election in 2002, Mr Gutiérrez survived by playing the country's political parties against each other. But it was a game in which he finally ran out of cards.

Dr Palacio, a cardiologist and former health minister from the coastal city of Guayaquil, was estranged from Mr Gutiérrez. He and his backers accused the ousted president of behaving like a dictator when he dissolved the court for the first time in December. Maybe so. But for the third time in nine years an elected president has been ousted in Ecuador, an oil-rich republic of notoriously fissile politics, by Congress and protesters in the streets (see table).

A *mestizo* (mixed race) former army colonel who himself had taken part in a similar coup in 2000, Mr Gutiérrez was elected with backing from left-wing parties. Once in office, he opted for orthodox economic policies, causing his backers to desert him. But his real problems began last November, when the conservative Social Christian Party (PSC) moved into opposition, backing a specious effort to impeach him.

To defeat this, Mr Gutiérrez forged a new alliance with two retrograde populist outfits. One is led by Abdalá Bucaram, a former president who had fled to Panama to escape corruption charges. The price of their support: the dissolution of the Supreme Court, dominated by the PSC, and its replacement with one sympathetic to the new alliance.

A lack of job security

Ecuador's presidents

Date	President	Details	Legal history*
1996-97	Abdalá Bucaram	Elected; ousted by Congress	$
1997-98	Fabián Alarcón	Appointed by Congress	$†
1998-2000	Jamil Mahuad	Elected; ousted by coup	🔑
2000-03	Gustavo Noboa	Mahuad's vice-president	🔑
2003-05	Lucio Gutiérrez	Elected; ousted by Congress	🔑
2005-?	Alfredo Palacio	Gutiérrez's vice-president	–

*Charged with: $ Corruption 🔑 Abuse of authority

Source: *The Economist* †Declared innocent

The opposition's outrage intensified in March, when the new court's president dropped the charges against Mr Bucaram (aka *el loco*, the madman). He promptly returned home and vowed to lead “a revolution of the poor”, in the mould of Hugo Chávez, Venezuela's president. That caused Mr Gutiérrez's new alliance to start to unravel. And it prompted daily protests, in Quito and other cities, calling on the president to go.

Ecuador remains in limbo. Some of the protesters called for new elections. But the first task for Congress is to decide how to choose a new Supreme Court. The court will have to decide whether to reverse its predecessor's decisions, such as that to exonerate Mr Bucaram.

Mr Gutiérrez made mistakes. But he did some things right. Helped by higher oil prices, Ecuador's economy grew by 7% last year. For the first time in decades, the government posted a fiscal surplus. His economic team's efforts to reform a bloated state were thwarted by an opposition that never really let the president govern.

Whatever respite it now enjoys, Ecuador's democracy is deeply discredited. The system is corrupt—but corruption charges are used as a political weapon. Mr Gutiérrez owed his election to his claim to be a political outsider. In the end that may have been his problem.

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Economist.com WORLD LATIN AMERICA

Fragile states in the Andes (2)

Pressure builds again in Bolivia

Apr 21st 2005 | LA PAZ AND SANTA CRUZ
From The Economist print edition

Unless compromise is struck over gas, the constitution and regional autonomy, South America's most troubled democracy risks becoming a failed state

AFP

For the street-fighting men, it's a gas, gas, gas

Get article background

THE capital of Bolivia's easternmost province, Santa Cruz, is prosperous and seething with frustration. It is a centre of commercial farming, and the local headquarters for multinationals pumping natural gas out of the country. There is nothing *cruzeños* want more than to export gas and soya beans. But for much of the past two years, radical groups from Bolivia's western highlands have done their best to prevent that. They have blocked roads in order to force foreign investors to bow to their demands or leave. To inoculate itself against such disruption, Santa Cruz wants to gain autonomy from the central government in La Paz.

Bolivia's tensions stir wider worries. If regionalism becomes separatism, other Andean countries could fray. With Hugo Chávez, Venezuela's authoritarian president, fomenting anti-American revolution across much of Latin America, Bolivia could be “the first domino” to fall, claimed *The Wall Street Journal* this month. Long the third-biggest producer of cocaine, if the country's shaky government loses authority, Bolivia, to some, risks becoming an ungovernable narco-state.

Bolivia's politicians propose to dodge disaster by reinventing the country. In August, for the first time, an election will be held for provincial governors. Together with a referendum on provincial autonomy, for which a date has yet to be fixed, this should placate Santa Cruz. Later this year, there will be a constituent assembly, which radical social movements are counting on to “re-found” Bolivia. But these developments could harden positions rather than narrow differences. Carlos Mesa, the popular but weak president, threatened to resign twice in March; he may not survive much beyond August, when the constitution allows a new general election.

An energy hub

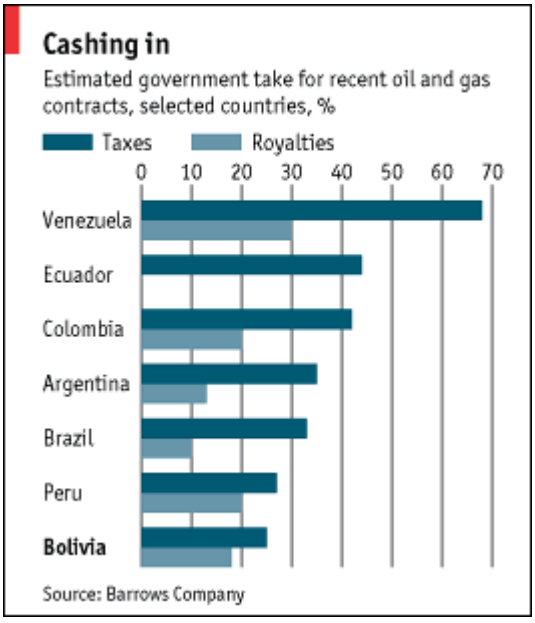
Even if Bolivia calms down, it is on the verge of blowing a historic opportunity: to become South America's energy hub. In the mid-1990s, a liberal-minded government privatised the oil and gas monopoly and invited foreign investors to look for more. Brazil's Petrobras, Spain's Repsol YPF, Britain's BP and others invested $3.5 billion, multiplying ten-fold Bolivia's proven and probable reserves of gas. Gas exports to Argentina and Brazil have quintupled since 2000 to $620m, about a third of total exports. With more investment, Bolivia could sell much more. That would not solve the problems of South America's poorest republic, but it would alleviate them. Yet Congress is close to passing a law that would have investors closing their wallets, calling their lawyers and, in some cases, packing their bags.

This is happening because social movements, which claim to represent the poor, indigenous majority, have found in gas a cause that cuts across lines of ethnicity and class. Most Bolivians share the suspicion that foreign investors are cheating the country of its natural resources. Bolivia's last president fell in 2003, after government forces killed some 50 protesters against a scheme to export gas through Chile, an historic enemy. Last year voters approved overwhelmingly a referendum that mandates higher taxes and greater government control over gas and oil.

The question is how that demand will be realised. Mr Mesa proposed a hydrocarbons law that seeks to raise the government's take of gas and oil revenues without driving investors away. In essence, it would rewrite contracts to vary taxes according to the size of a gas field (which affects its profitability) and encourage investors to accept them.

But under pressure from the social movements, led by Evo Morales, who heads a coca-growers' union and is a congressman and presidential hopeful, Congress appears close to approving a far more draconian regime: a sharp rise in royalties from 18% to 50%, “obligatory migration” to the new contracts, and controlled prices. The energy companies are united in their outrage. A “bible of corruption” that is “geared toward socialism” is what Edward Miller, whose company operates a gas pipeline from Santa Cruz to Brazil, calls the proposed law.

Mr Morales's allies argue that Bolivia is surrounded by potentially big gas consumers. Argentina, which uses gas to generate about half its electricity, is short of it and eager to import more. Brazil, the region's industrial powerhouse, wants to reduce its reliance on hydropower. Oil prices are high and the current tax regime is not oppressive, so there is room for a greater government share (see chart). Even moderate Bolivians think the country is in a strong bargaining position. “The world's energy needs are big and will be bigger in the future,” predicts Guillermo Torres, the mining and energy minister.



Delusions of grandeur, the energy companies retort. Popular rejection of a pipeline to Chile, to export liquefied natural gas to Mexico and California, was a colossal blunder, they say. The alternative route through Peru would cost much more. Now Russia and Indonesia will supply what could have been Bolivia's biggest market. Argentina's gas shortage is caused by a price freeze, which discourages investment in new supply. If its government comes to its senses before Bolivia's, part of its demand could disappear. Brazil has

recently discovered gas offshore, which “throws a huge spanner in the works,” according to Jed Bailey of Cambridge Energy Research Associates, a consultancy. So Bolivia's gas can look forward to an exciting future under the ground.

No doubt there is room for negotiation. “Companies are always open to find a way,” says Raúl Kieffer, head of the industry's Hydrocarbons Chamber in Santa Cruz. But if contracts are abrogated the costs will be high. Billion-dollar projects that are now on hold, such as a new pipeline to Argentina and a petrochemical plant on the border with Brazil, will either be dropped or cost more. Investors could sue for “billions”, says Mr Kieffer.

Catastrophic stalemate

The gas row is a business dispute caught up in a social revolution. The 60% of Bolivians who are poor, rural and of indigenous origin have historically suffered discrimination. They are kept down by an economy that produces just 30,000 jobs for the 120,000 people who enter the workforce each year. Their grievances have found an outlet not in traditional political parties, which are seen as elitist and corrupt, but in social movements like Mr Morales's coca-growers' union or neighbourhood groups in El Alto, a satellite city of La Paz. Their main weapon is the road block, which has the perverse effect of killing jobs that would alleviate the blockaders' poverty. Behind them, critics allege, there stands the malign influence of Venezuelan petrodollars and European NGOs.

AFP

It's tough underfoot in a blockaded economy

They are not monolithic. Mr Morales's demand for more coca in the Chapare region does not resonate in the parts of the Yungas where coca is grown legally for traditional use. His multicultural vision of Bolivia is gentler than that of Felipe Quispe, an Aymara Indian leader from the high plain around La Paz, who wants to restore the paradise that prevailed before colonisation. Yet on energy and indigenous rights the social movements are united.

They expect the constituent assembly to prise open institutions, possibly with quotas, and redistribute wealth, largely through land reform. This stirs alarm above all in Santa Cruz, where big landholdings underpin both entrepreneurial agriculture and feudal privilege. The province has some good reasons for wanting autonomy: the central government's power of appointment extends from school-teachers to provincial governors. La Paz province, with roughly the same population as Santa Cruz, has seven times the number of policemen, says Óscar Ortiz, of the regional chamber of trade and industry. But the most emotive issue is land. The regionalist cause attracted 400,000 people, a fifth of the province's population, to a rally in January. The

confrontation between them and the social movements is a “catastrophic stalemate,” says Álvaro Linera, a sociologist in La Paz.

Resolving this requires two things: reconciliation between the social agenda and the regional one, and a restoration of government authority. The autonomy referendum and the constituent assembly are elements of the first, but details are all-important. What sort of autonomy will be on offer? *Cruzeños* like the Spanish model, where degrees of autonomy vary by region. Will a newly elected Congress become the constituent assembly, as Mr Mesa suggested in one of his resignation threats? Or will the assembly have a built-in indigenous majority, as the social movements want? Will the autonomy referendum allow provinces, in effect, to opt out of any new constitution?

Restoring authority may turn in part on the regional elections. The nine elected provincial governors will rival the president in legitimacy and influence. They could use that to shore up the battered authority of Mr Mesa. He has felt obliged to forswear the use of force against the road blocks and failed to get results from Congress. Now he is expected to create a slate of centrist candidates to take on both the traditional parties and the left. If he captures three or four of the nine provinces, Mr Mesa will have “more power to negotiate with Congress,” says Gonzalo Chávez of Bolivia's Catholic University. Even if he fails, the governors could be a counterweight to the feckless Congress and the lawless social movements. If the right does well, Santa Cruz may relax.

But the politics of gas may well get in the way. These took a bizarre turn this month, when the constitutional tribunal cast doubt on all energy contracts, by suggesting that Congress should have approved each individually. Incipient talk of compromise, even from the social movements, faded. A draconian gas law could prompt Mr Mesa's veto and, probably, his third and final resignation. That would trigger a general election, which many Bolivians think is the only way out.

It could be, but only if the new government contains or co-opts the disruptive left. Mr Morales, the only leader so far who straddles traditional politics and the streets, shows flashes of moderation. His Movement to Socialism has a fifth of the seats in Congress. In municipal elections in December, it won more votes than any other party—but only 18%. He dreams of becoming president, but cannot do so without support from the middle class, which loathes the road blocks. One poll found that disapproval of Mr Morales rose from 60% in January to 73% in March. He has suspended road blocks while the Senate considers the gas law.

But in a fragmented political system, even a more moderate Mr Morales would be no shoo-in for the presidency. He may well return to the streets, forcing the government once again to choose between repression and surrender. He will remain “a tremendous thorn” in Bolivia's side, making it “almost impossible to govern,” fears Scott Mainwaring, a political scientist at the University of Notre Dame. Unless, that is, Bolivia's more responsible politicians rediscover their backbones.

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Economist.com WORLD ASIA

China and Japan

Managing unrest

Apr 21st 2005 | BEIJING AND TOKYO
From The Economist print edition

AP

Protests against Japan cause official unease in China

Get article background

CHINA'S leaders are at last showing some disapproval of the anti-Japanese protesters who have staged large, sometimes violent, demonstrations in a dozen cities over the past three weekends. But the biggest outpouring of xenophobic unrest in China for more than six years looks likely to rumble on. If so, further damage will be done not only to China's relations with Japan, but also to its efforts to convince its neighbours that its economic rise poses no threat to their security.

A visit to China this week by Japan's foreign minister, Nobutaka Machimura, failed to produce any obvious agreement on how to end the unrest. China refused Japan's request for an apology for damage to Japanese property during the protests, even though Chinese police have done little to stop protesters from throwing stones and other projectiles at Japan's diplomatic missions. A meeting between China's president, Hu Jintao, and Junichiro Koizumi, Japan's prime minister, could take place at an Asia-Africa summit in Indonesia this week. But as Mr Hu flew to Jakarta on Wednesday, there was no official word that such a meeting had been planned.

For the first time, however, China has indicated that it wants the demonstrations to stop. On April 19th the foreign minister, Li Zhaoxing, called on citizens to "express their feelings in a lawful and orderly way" and not to take part in "unapproved demonstrations or activities that may affect social stability." By China's standards, these were mild warnings. There was neither mention of what might happen to violators, nor any threat of action against participants in the unauthorised protests that have already taken place. Other Chinese officials meanwhile continued to blame

Japan for the unrest.

China's leaders are probably uneasy, nonetheless, about the impact the protests are having on their country's image, as well as about the risk that the crowds could turn on the government if their protests are harshly suppressed. The failure of protests to materialise in Beijing last weekend, despite calls for them circulated on the internet, will have been a comfort. This followed a warning from the capital city's police that unauthorised protests would be treated as illegal.

But a similar warning in Shanghai failed to deter tens of thousands of people from taking to the city's streets on April 16th, chanting "Japanese pigs get out" and "Kill the Japanese" as they marched on the Japanese consulate and pelted it with stones. The next day, thousands protested in several other cities, including Shenyang in the north-east, Shenzhen on the border with Hong Kong and Hong Kong itself. Nationalists have called for more protests during the coming week-long May Day holiday, especially on May 4th, the anniversary of anti-Japan protests in 1919.

If this agitation has worried China's leaders, they have shown no inclination to address its cause by instructing the government-controlled media to present Japan's position more objectively. The protests have been inspired mainly by Japan's bid for permanent membership of the UN Security Council, and the Japanese Education Ministry's approval of school textbooks that play down Japan's atrocities in China in the 1930s and 1940s. Chinese media have failed to highlight that only a handful of schools would use the most egregious textbook and that Japan has apologised numerous times for its wartime behaviour. Mr Koizumi's ill-judged visits to the Yasukuni Shrine in Tokyo, where some war criminals are among those honoured, have been highlighted. But there has been little mention of the tens of billions of dollars in aid Japan has given to China in the past two decades.

The protests could have a significant impact on tourism between Japan and China during the May Day holiday, which coincides with Japan's Golden Week. For Japanese and Chinese, this is a popular time for travel. Thousands of Japanese have cancelled plans to visit China. Bookings by Chinese for trips to Japan (where the protests in China have prompted threats to Chinese diplomatic missions, but otherwise elicited a calm response) are also unusually few for the coming holiday.

Japanese businesspeople, whose factories in China employ some 1m Chinese, worry about calls by Chinese activists for a boycott of Japanese goods. There has been no indication so far of any major boycott. But at the weekend, hundreds of Chinese workers at factories run by Taiyo Yuden, a Japanese electronic parts company, went on strike in the city of Dongguan, near Shenzhen. Though related to the anti-Japanese protests, the strike was also triggered by complaints over pay. Given that much Japanese manufacturing in China is geared towards markets outside China, such disruption arouses far greater concerns than a possible decline in Chinese demand. Tokyo's Nikkei index fell nearly 4% on April 18th to a four-month low. Although this reflected other economic factors, the protests in China played a part.

This week a Chinese deputy foreign minister, Wu Dawei, said his country's ties with Japan were at their worst since the rivals established diplomatic relations in 1972. Another Chinese official said that what China considers Japan's meddling in the Taiwan issue was also aggravating tensions, and could be "very dangerous".

The Asia-Africa summit in Indonesia is intended to display friendship among Asian and African countries which took part in the Bandung Conference in Indonesia 50 years ago, leading to the non-aligned movement. But between the biggest powers attending, little love will be lost.

India and Pakistan

Point of no return?

Apr 21st 2005 | DELHI
From The Economist print edition

The peace process gathers momentum

AP

Quite happy together

FOR once, a meeting between Indian and Pakistani leaders ended in hope not recrimination. Pakistan's president, General Pervez Musharraf, this week paid his first visit to India since a disastrous summit in 2001. This time, an international cricket match was the excuse for an "informal" visit that nevertheless bore all the trappings of a summit. It achieved no great breakthrough, but General Musharraf and India's prime minister, Manmohan Singh, claimed something even better—that "the peace process was now irreversible". It is not, of course. General Musharraf himself argued that, in the absence of a "final settlement", the Kashmir dispute, over which the two countries have fought three wars, could erupt again. But, for now, both sides are preoccupied not with the risk of war, but with the potential benefits of peace.

The co-operative mood had been set by the opening, on April 7th, of a bus route between Srinagar, capital of Indian-held Kashmir, and Muzaffarabad, capital of the Pakistani part, for the first time since partition in 1947. The service brought the hope of reunion to separated Kashmiri families, but also showed a new willingness by both governments to compromise on long-held sticky positions. It helped that Pakistan joined India in condemning an attack by Kashmiri separatists on some of the buses' passengers before they left Srinagar.

In Delhi, General Musharraf and Mr Singh agreed to increase the frequency of the buses, which initially will travel only once a fortnight, and to let goods lorries ply the route. More routes will be opened, as will meeting points for separated families and trade along the "line of control" that divides Kashmir. The hope is that a "soft border" will help Kashmiris on both sides, and bring a final settlement closer. Beyond Kashmir, there were other moves designed to promote bilateral trade, such as reactivating a moribund joint economic commission. A dispute over a dam under

construction in Indian Kashmir—the trickiest bilateral economic issue of the moment—was ignored in the leaders' joint statement.

Since Mr Singh's predecessor, Atal Bihari Vajpayee, offered Pakistan "the hand of friendship" two years ago, India has sought to build confidence through increasing contacts, expanding economic ties and taking advantage of the popularity in both countries of moves towards peace. In doing so, it has had to counter the suspicions of many in Pakistan and in Kashmir that India was seeking to enmesh Pakistan in a spider's web of minor accords without tackling the central dispute: Kashmir. Both countries claim all of Kashmir, though India has long let it be known that it would settle for the status quo. Many in Kashmir, however, yearn for independence from both countries. For 15 years, the Indian part has suffered a bloody insurgency, abetted by Pakistan.

In Delhi, General Musharraf met separatists from Indian-held Kashmir. Moderates among them have welcomed the peace moves, but bemoaned the lack of a Kashmiri seat at the negotiating table. Hardliners accused the general of betrayal.

A solution to the Kashmir dispute still looks a tall order. General Musharraf said it would have to fall within three guidelines: India's insistence that no boundaries can be redrawn; Pakistan's refusal to accept the line of control; and the two countries' agreement that borders must become less important. But the first two are mutually incompatible; and the flexibility needed to blur the contradiction seems at odds with General Musharraf's insistence that there must be a "final settlement".

Yet the two leaders have agreed that they will not "allow terrorism to impede the peace process". This implies that Pakistan is distancing itself further from "freedom fighters" in Kashmir, and that India is not going to treat every terrorist attack as if it were an act of Pakistani aggression. Peace may be far off; but the threat of war is no longer just one atrocity away.

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Pakistan

A military reception

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From The Economist print edition

An opposition politician congratulates the government after it arrests him

ASIF ZARDARI'S sole claim to fame used to be his wife, Benazir Bhutto, Pakistan's exiled, two-time former prime minister. Not any more. In November, he was freed from prison—after eight years on remand for many alleged crimes—to a hero's welcome in Sindh, the home of Ms Bhutto's Pakistan People's Party (PPP). On April 16th, after visiting his wife in Dubai, Mr Zardari flew to Lahore, the home of Pakistan's ruling army elite—to a reception that may say much about the future of Pakistan.

On the eve of Mr Zardari's arrival—accompanied by dozens of journalists at his expense—thousands of PPP supporters were arrested in Lahore. On arrival, he was bundled into a police car and driven to his own house in the city. The journalists were roughed up by police and their audio-tapes confiscated.

But Mr Zardari had no words of comfort for them—or for the thousands of PPP activists arrested on his behalf. Instead, he praised the government of General Pervez Musharraf. He also vowed not to support General Musharraf's erstwhile ally, a six-party Islamist coalition, the Muttahida Majlis-i-Amal, which recently demanded that the general stand down as president. In fact, it is well-known that General Musharraf has sought support from the PPP instead. By giving the party a share of power, he may hope for its help in an election in 2007, thereby enabling him to retain power until 2012. As for afterwards, Ms Bhutto may not become prime minister for a third time, but Mr Zardari would love to stand in for her.

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Economist.com WORLD ASIA

Singapore

Dicing with vice

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The government legalises casinos

"WE WANT Singapore to have the X-factor, that buzz that you get in London, Paris, or New York." That is how Lee Hsien Loong, Singapore's prime minister, announced his government's decision to legalise gambling in the country, in the form of two large, Vegas-style casinos. Whether the casinos will indeed help to transform Singapore's staid image remains to be seen. But the decision has already prompted an uncharacteristic buzz among the country's normally quiescent citizens.

The government has contemplated, and rejected, licensing casinos several times in the past. One reason was that Singapore's economic growth was so rapid that casinos seemed like an unnecessary evil. Buddhism and Islam, two of the country's main religions, frown on gambling. The government itself has traditionally had strong, and often moralistic, ideas about how its citizens should behave. Until recently, for example, it refused to admit homosexuals to the civil service. It also used to ban chewing gum, which it considers a public nuisance.

Nowadays, however, Singapore's electronics industry, the mainstay of the economy, is struggling to cope with cheap competition from places like China. In the first quarter of this year, output shrank by 5.8% at an annual rate. So the government wants to promote tourism and other services to make up for vanishing jobs in manufacturing.

Merrill Lynch, an investment bank, reckons the two proposed casinos could bring in as much as $4 billion in the initial investment alone. According to its estimates, they would have annual revenues of up to $3.6 billion, and pay at least $600m in taxes and fees. The government, for its part, thinks the integrated resorts, as it coyly calls the casinos, would generate as many as 35,000 jobs.

It also thinks the economy (and the tourism sector in particular) will fare better if Singapore is seen as a livelier, less regimented place. So, for example, the censors are reaching for their scissors less often: citizens now have access to previously taboo items such as *Cosmopolitan* magazine and "Sex and the City", a racy television show. Last year, as part of a trade agreement with America, the government even went so far as to legalise the import and sale of chewing gum, albeit only of the sugarless sort, only in pharmacies, and only to customers who register. The new casinos, needless to say, would be in keeping with this increasingly permissive atmosphere.

But so is noisy public opposition. A group called Families Against the Casino Threat in Singapore, or FACTS, has been distributing bumper stickers reading "Casi-NO". Almost 30,000 people have signed its online petition against the casinos: a bold display of defiance in a country that has been run by the same political party for the past 40 years. "We were pleasantly surprised that there were so many people," says Fong Hoe Fang, one of the founders of FACTS, "because in Singapore, people are a little afraid."

The government, conscious of this opposition, has promised all kinds of restrictions to limit the social fallout from the casinos. Singaporeans will have to pay a fee of 100 Singaporean dollars ($60) to enter them. Gambling will take up only 5% of the floor-space at the resorts. Nor will the

casinos be allowed to offer credit to locals, or to advertise locally.

The government has even offered to include critics of the casinos on a new council it is setting up to combat the ill-effects of gambling. But Mr Fong, for one, says he is not interested in helping the authorities clean up a mess of their own making. Instead, he wants to pursue his campaign. Some FACTS supporters are even urging him to convene a public demonstration; but, given the government's authoritarian instincts, he says, that is too much of a gamble.

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China

Write us a letter

Apr 21st 2005 | BEIJING
From The Economist print edition

An ancient practice gives poor people a voice, but not justice

MANY Chinese cherish the memory of Bao Qingtian, a judge of the Song dynasty, whose reputation for sticking up for the common man has endured for 1,000 years. This may be because honest and competent officials can be hard to find in the Middle Kingdom these days. But that does not deter hordes of poor men and women from trying: each year, millions of them, in a curious hangover from the imperial past, individually petition the government for help.

To bring their cases before the relevant ministry, many journey to Beijing, where they may spend several months camping out near the city's southern bus station. The campers tell harrowing tales. A woman from Shandong says she has come to demand justice for her son, who was murdered by her local police chief's thuggish son. Other petitioners rail about land stolen or jobs lost. Most wield wads of supporting documents.

Clearly, confidence in China's law courts is not high. Last year, the government reported a 60% rise in the number of petitioners seeking to circumvent them. By one estimate, over 10m petitions are ongoing. At the local level especially, judges are often poorly schooled and corrupt. And yet, according to a survey by the Chinese Academy of Social Sciences (CASS), only two out of every thousand petitioners are successful. Many claimed to have been beaten or jailed by local officials in a bid to stop them running to Beijing telling tales.

In an effort to prune back the petitions system and prevent local officials from retaliating against those who use it, the government is due to introduce reforms on May 1st. But some academics say the system should be scrapped altogether, because it is inefficient and contrary to China's creeping effort to install the rule of law.

And yet, in such a vast and still patchily developed country, the petitioners serve another important purpose. Nine out of ten of them told the CASS's researchers that they wanted simply “to let the centre know about their situation,” and, it seems, the centre wants to hear them. While free speech remains suppressed in China, the petitioners offer the government in Beijing a rare opportunity to gauge the mood of the provinces. And if the practice convinces some poor Chinese that their voice is being heard, so much the better: to hold off democracy, China's leaders will happily put up with some whingeing peasants.

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Economist.com WORLD ASIA

China's Christians

Crossing the Communists

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Christianity is becoming popular with China's urban elite

The official churches tell only part of the story

THE late pope, John Paul II, often said that one of his greatest dreams was to visit China. If his successor, Benedict XVI, achieves that goal, and with it an end to half a century of estrangement between China and the Vatican, he will find a country remarkably receptive to Christianity, in spite of the Communist government's deep suspicion of religion. But the Catholic church will have some catching up to do; it is Protestantism that in recent years has spread most rapidly in China, even among the usually sceptical urban elite.

Quantifying Christian belief in China is fraught with difficulty. The avowedly atheist authorities try to prevent surveys by foreign or Chinese researchers that might challenge the official view that Christianity is still a marginal phenomenon. Numbers presented by Christian activists, on the other hand, may reflect a degree of wishful thinking. Officially, there are 5m baptised Catholics and 15m Protestants. Vatican officials believe there are more than 10m Catholics. In its report last year on religious freedom, the American State Department quoted estimates for the Protestant community ranging from 30m to 90m. These unofficial tallies would mean that 2-7% of China's population is Christian.

The most rapid spread occurred in the 1980s after the lifting of China's Maoist-era ban on religious activity and the reopening of thousands of Christian churches. Believers were typically elderly, little-educated and poor. But, since then, the average age of believers has fallen and worship in places not sanctioned by the government has become more common than in officially-approved churches.

For the government, the recent proliferation of house churches—informal gatherings of Christians in private homes or other unauthorised locations (by law, organised worship must take place in sanctioned venues)—is especially alarming. It regards such activity among Catholics as open

defiance of the Communist Party, which in 1951 ordered China's Catholics to break ties with the Vatican. The government's attitude towards Protestant house churches is less antagonistic, but it fears that some provide cover for dissidents. There are frequent reports of house-church leaders being arrested or harassed.

Most striking in recent years has been the spread of Christianity among urban intellectuals and businesspeople. A Chinese academic (and party member) at a government-affiliated institute says that in the past five years especially, Christianity has flourished on university campuses. Most universities, he says, have several clandestine Christian “fellowships”, comprising students, graduates and teachers, who meet regularly to read the Bible and discuss their faith. “You'd be astonished to see these meetings. They are completely different from the way we've viewed house churches in the past, as places that attract old women and the illiterate with little scientific understanding,” he says.

At Renmin University of China in Beijing, Li Qiuling says his lectures on western religious culture are not only fully attended by the 100 students registered on his course, but also by dozens of others who simply want to listen in. Mr Li says very few students attend church and most have little interest in organised religion. But they are interested, he says, in Christian values. David Aikman, the author of “Jesus in Beijing”, a book about the growth of Christianity in China, says there are probably dozens of Chinese universities teaching Christian culture.

Anecdotal evidence suggests a growing interest in Christianity among businesspeople. Some have embraced the faith during studies in the West. The academic cited above says companies in China are increasingly keen to sponsor academic symposia related to Christianity. He says the recent spread of Christianity among this educated elite marks “a very critical change” in the development of the religion in China.

Why all this interest? Although foreign Christian missionaries were active in China long before the Communist takeover in 1949, Christianity never had anything like the popularity it enjoyed in eastern Europe and the former Soviet Union before communism came to those parts. Since the relaxation of China's religious controls a quarter of a century ago, foreign missionaries have returned to China, often under the guise of teaching at Chinese universities. But the urban elite's yen for Christianity is little related to their efforts.

Some say it denotes a crisis of faith over the failings of communist ideology. China's conversion to capitalism has prompted a search for values that might help counter the negative side-effects of this transformation, such as corruption. But, if so, why not turn to faiths with a much longer history in China, such as Buddhism, Taoism or Confucianism?

These religions are also enjoying a revival. But Christianity appeals particularly to intellectuals because it is the faith most deeply rooted in the countries that well-educated Chinese most envy—principally America. “Some people have begun to think that the birth of capitalism and modern science in the West is not entirely unrelated to Christianity,” says Mr Li. Protestantism is especially attractive because it lacks the political baggage accrued in China's rows with the Vatican, including over relations with Taiwan.

None of this has gone unnoticed by China's leaders. Last year, they launched a campaign to promote atheism in schools. An internal party document recently railed against “illegal missionary activity”. New regulations on religious activity took effect in March. These insisted the government must maintain its grip on religions and places of worship. Yet this grip is clearly faltering.

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Syria

Sitting tight

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From The Economist print edition

Beset with headaches at home and abroad, Syria's president has apparently decided to remove his troops from Lebanon, then play for time—and do nothing

A SWANKY shopping centre is not the first sight of Baathist Syria one might expect, snuggled in the barren mountains along the road from Beirut, the Lebanese capital which has recently been chafing under Syria's two-decades-old grip. Odd, too, that the store stocks more than just the usual duty-free fare; for example, prescription drugs that cannot be found on the other side of passport control. “Don't feel like stopping?” shrugs this correspondent's driver, and then adds with a snicker, “Don't worry, Rami Makhlouf will get your money anyway.”

He is right. Mr Makhlouf, a younger cousin of Syria's 39-year-old president, Bashar Assad, has stakes in cellphone companies, factories, hotels and even private schools. In fact, along with a handful of other sons and intimates of top regime figures, he owns much of what shines amid the pervasive greyness of Damascus.

But there is something else new on the crowded streets of Syria's capital: a mood of suspense, a sense of inevitable change or, some say, impending doom. One reason is the drama unfolding in next-door Lebanon since the murder in February of its popular former prime minister, Rafik Hariri. By the hundreds of thousands, ordinary Lebanese have clamoured for, and won, the removal of Syrian forces—a spectacle that has both exhilarated and dismayed their Syrian neighbours.

Those troops, installed since 1976, will be gone by the end of this month. So too will the garish Assad posters and the visible part of Syria's extensive intelligence apparatus. Subtler means of influence will surely remain, since Syria will still see Lebanon as a bulwark against Israeli

encroachment. For instance, Lebanon's newly installed prime minister, Najib Mikati, is a partner in one of Mr Makhlouf's cellphone networks. But Mr Mikati's government has a short brief, which is to hold elections that, under the eye of the outside world, are expected to reflect Syria's diminished ability to dictate results.

Syrian influence has faded on other fronts, too. The country's state-controlled press trumpeted a recent visit to Damascus by Turkey's president, Ahmet Necdet Sezer, as a foreign-policy coup. But his advice was that Syria ought to watch its step or face further isolation. Damascus gambled, and lost, on America “losing” Iraq (see article). Despite ceasing support for Iraqi rebels, it remains subject to some American sanctions. Meanwhile, French anger over Lebanon, plus Syria's failure to lobby the European Union's newer members, have set back hopes of a trade deal with Europe. And Syria's loneliness has allowed Israel to ignore Mr Assad's repeated peace overtures.

Most Syrians hope the withdrawal from Lebanon augurs a renewed focus on fixing their country's own problems. The pull-out does appear briefly to have boosted Mr Assad's appeal. He needed the boost. Since succeeding his father five years ago, his credibility has waned as promised reforms, both political and economic, have failed to materialise.

True, Syria's regime has freed all but a few hundred political prisoners, invited some exiles back and let opponents talk without fear of immediate arrest. But activists remain stifled by controls on the press and other forms of public life. Ordinary folk complain of corruption and of a resurgence of sectarian tensions. Last year saw riots among restive Kurds and Assyrian Christians in the east of the country. More recently, Ismaili Muslims have held protests, and observers note the majority Sunnis' growing resentment of Mr Assad's still-dominant Alawite sect, which makes up less than 15% of Syria's 18m people.

The door to a freer market has opened a crack. Coca-Cola, long subject to an anti-Israel boycott, now adorns supermarket shelves (smuggled from Lebanon, with a wink from the Syrian army). Joint-venture banks have opened and automatic telling machines sprouted. Yet while the new banks have sucked in depositors grateful for better service than in their dowdy state-owned competitors, the cash sits mostly unused. The government has yet to devise sound rules for private lending.

A few years back, Syria earned useful bonuses from smuggled Iraqi oil, aid from friendly Gulf countries and the take from Lebanon. The first two sources have evaporated. The last, which some Lebanese reckon brought in well over $1 billion a year (from such things as regime holdings in Lebanese utilities, cuts on customs duties and a purported interest in a casino), is likely to dwindle. Lebanon has stopped absorbing Syria's unemployed. Ugly chauvinism, including attacks on Syrian labourers, has prompted as many as a quarter of Syria's estimated 400,000 migrant workers to leave Lebanon since February.

More serious, however, is a projected steep fall in Syria's own oil production, which accounts for 70% of its exports and around half of government revenue. Experts differ as to when the crunch will come, but one guess is that within seven years Syria will be a net importer of oil. Mr Assad has hired a few young, competent technocrats. But such people have found it nearly impossible to gain traction in a system that has repelled talent for decades.

Mr Assad has also thinned the top-heavy ranks of Syria's army. Yet this may be less an improvement than a bid to install officers more loyal to him. Many of the new appointees are Alawites: a sign, perhaps, that the regime is circling its wagons. (But a move to trim the length of obligatory military service has been popular.)

Some pin hopes on the Baath party, which is to hold a long-delayed congress in June. Hinted reforms include allowing free local and even presidential elections, and letting rival parties form.

Such promises have been heard before, however. It is six months, for example, since officials floated the idea of doing something for the tens of thousands of Kurds who have lived in the country for generations, but whose citizenship was revoked in 1961. Some Kurdish political prisoners have been released, but they and their kin remain stateless.

The regime may have failed to realise that change is its best hope of survival. “They see the Iraq model, and it's a mess, and on the other side Lebanon, which is just as bad,” says a lawyer in Damascus. “They don't see beyond that, and are likely to conclude that the best option is to do what they are best at, which is nothing.”

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Lebanon and Iraq

The influence of Shia clergymen

Apr 21st 2005 | HARIS, SOUTH LEBANON
From The Economist print edition

Shia clergy spread their message, from Iraq and Iran to Syria and Lebanon

AP

A new spirit of free-wheeling debate

CROSS-LEGGED on cushioned carpets, the latest intake of novices at a sparkling Shia seminary forsake their Koranic rhetoric for the view through curtained French windows at hills rolling over to Israel. Welcome to Lebanon's Shia *hawza*, country-club style. Vast mansions and religious colleges built by Lebanon's West African diamond merchants and exiles in Detroit stud the land that Hizbullah, Lebanon's Islamist Shia movement, took back from Israel five years ago, interspersed with portraits, strung from lamp-posts, of dead guerrillas.

The Najaf College for Islamic Studies, named after the Shias' holiest city 1,000km (620 miles) away in southern Iraq, is one of dozens of religious Shia colleges to sprout in Lebanese villages over the past decade. They pay pupils stipends of $60 a month, teach their own curricula and build up separate identities that put religion above nationality. Traditional heroes, such as Saladin, who conquered Jerusalem for Islam and whose Tabnin castle still towers above the Najaf College, are recast as Sunni butchers who overthrew the Arab world's last Shia state.

Before the civil war that lasted from 1975 to 1990, less than a third of Lebanese students went to private, mainly sectarian, schools. Now 60% do. The bankrupt state increasingly relies on party institutions and religious foundations to provide basic services. Lebanese look to their confessional leaders to provide work—in orphanages, hospitals, banks, football clubs and even at petrol stations. Patriarchs and muftis are political kingmakers.

Six decades of confessional rule and 15 years of displacement in sectarian wars have left Lebanon a patchwork of rival communities. The Taif accord of 1989, which ended the civil war, failed to heal the divisions and left most of the old commanders in charge. Sectarian factions operate like states within states, with multi-billion-dollar concerns. The youngest and most zealous, Hizbullah, inspects foreigners' passports and openly runs its own army, bucking a UN resolution last autumn that told it to disarm.

But outside pressure on Hizbullah to disarm has recently coincided with growing dissent among Shias themselves. Sparked by America's liberation of the *hawza* in Najaf itself, the historic nerve-centre of the world's 170m or so Shias, Lebanese Shias are re-examining their attitudes to clerical power. A representative of Najaf's spiritual leader, Grand Ayatollah Ali al-Sistani, calls on Lebanon's clerics to apply his *fatwa* to abstain from political office and says that Lebanon's Shias should choose their own future without truckling to Iran, the foremost Shia state.

One of Lebanon's two main Shia parties, Amal, agrees. “We are with Sistani and his theory of

government," says Sheikh Abdel Emir Qabalan, Amal's spiritual leader, who looks to a revived Najaf to free Arabs from Persian clutches. Another member of Mr Qabalan's Higher Shia Council in Lebanon insists that Hizbullah should disarm as soon as Israel withdraws from the disputed Shebaa Farms, on the Israeli-Lebanese border.

But Hizbullah has so far turned a deaf ear to such advice. While iconic slogans of Syria's President Bashar Assad appear to have been put away, cardboard cut-outs of Iran's leaders loom large over southern Lebanon, and the party faithful still hail Iran's Supreme Leader, Ali Khamenei, as their *Wali al-Faqih*, or clergyman-commander. Western diplomats say that Iran gives Hizbullah some $200m a year.

For now, Iraq's Najaf is too poor and insecure to challenge the dominance of Iran's clerical centre, Qom. "Sistani is a pacifist who should have resisted the American occupation long ago," sneers a Hizbullah propagandist. But even Hizbullah, some of whose officials say they would like to follow Mr Sistani's advice, shows signs of reconsidering. Over the past decade, it has watered down its slogans from "Islamic revolution in Lebanon" to "Islamic resistance" and most recently "Defence of the borders from another Israeli invasion".

In return for international security guarantees, the movement which America's former deputy secretary-of-state, Richard Armitage, once called "the A-team of terrorists to al-Qaeda's B-team", is talking about integrating itself into Lebanon's regular army and body politic. It long ago stopped boycotting Lebanese elections, and now controls 60% of the country's Shia municipalities. In Lebanon's next government, it might accept ministerial posts. "Hizbullah's military goals have to a large extent been achieved," says a prominent Shia. "If we abolish our military section, Hizbullah can survive by [focusing] on politics and its social dimension."

Hizbullah's leaders are not alone in dreaming of creating their own confessional state. Many Maronite Christians yearn for one, too. But the recent demonstrations in Beirut proved that more Lebanese want an end to the victor-or-vanquished mentality. "Lebanon is a blessing from God, a small experiment of 18 sects to teach the world how to live together," says Sadr al-Din al-Sadr, son of the spiritual mentor of both Hizbullah and Amal. "If it fails here, it can work nowhere."

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Economist.com WORLD AFRICA & MIDDLE EAST

Liberia

Daddy wore a blue helmet

Apr 21st 2005 | MONROVIA
From The Economist print edition

A school for the offspring of scandal

Get article background

THE UNECO children's centre looks like any other Liberian school. Its pupils wear smartish uniforms and are eager, after 14 years of civil war and not much schooling, to learn. What is unusual is that every child at UNECO has been fathered by a foreign peacekeeper and then abandoned. The centre was founded by Dr Abraham Cole, a local teacher, “to show our gratitude to peacekeepers by taking care of their children.”

Despite its name, the school receives no UN support besides food from the World Food Programme. Most of the 136 children at UNECO and a similar centre further north were conceived during the 1990s, when both the UN and Liberia's West African neighbours sent troops to Liberia. The number of abandoned babies is now set to surge, however. For the past 18 months, Liberia has hosted one of the largest and most successful UN peacekeeping missions, whose 15,000 blue helmets have now been around long enough to make more babies. A UN staffer said he expected 1,500 UN babies by the end of next year.

These children are not orphans. Their fathers are mostly alive, but have finished their tour of duty and gone home, often to waiting wives. Their Liberian mothers abandon them either because they are poor, or because they have married a Liberian man who does not want a half-Nigerian child in his home.

In a broken state like Liberia, where 80% of the population live on less than 50 cents a day and women can be seduced by the promise of a mobile-phone scratch card, it is not easy to keep well-paid soldiers chaste. But it would be nice if the UN tried a bit harder. After a scandal in Congo last year, when Moroccan UN peacekeepers were charged with raping 13-year-olds, Kofi Annan, the UN secretary-general, proclaimed a policy of “zero tolerance” for sexual exploitation. A report by Jordan's UN ambassador called for deductions from absentee fathers' salaries and courts martial in the country where any sexual offence takes place. But in practice, erring peacekeepers are rarely punished. Absentee fathers, rapists and even murderers simply disappear back home.

Some UN contingents in Liberia ban their members from bars. Some offer distractions such as gyms and movies, but the monthly budget for fun is only $8 per peacekeeper, and the thrills of table-tennis must eventually pall.

About 8% of Liberian adults are estimated to be infected with HIV, though the true figure may be higher—the recent civil war brought an epidemic of rape. Dr Cole visits barracks to persuade peacekeepers and their “camp girlfriends” to use condoms (the UN issues five per man per week), but it is not an easy task. Soldiers are inured to risk. And though Dr Cole has written to the UN asking for help with his school, he has yet to receive a reply.

Eritrea

Whispers of a new war

Apr 21st 2005 | ASMARA
From The Economist print edition

Eritrea is poor, tyrannical and cornered

THE United Nations peacekeepers in Ethiopia and Eritrea are worried. Tensions between the two countries are rising. Given that their border war of 1998-2000 cost 70,000 lives, this is ominous. Both the UN and the Eritrean government gave warning this month that the continuing stalemate could slide back into war.

When the two sides signed a peace deal in 2000, they agreed that an independent Boundary Commission would tell them where their border should be. But when the commission awarded the disputed two-goat town of Badme to Eritrea in 2002, Ethiopia rejected the ruling. A brittle truce has prevailed since then. Last November, Ethiopia finally said it accepted the commission's decision “in principle”, but insisted on further talks. It then moved 50,000 troops closer to the border.

Eritrea may have international law on its side, but no global policeman seems inclined to enforce it. With 16 times the population, Ethiopia is commercially weightier. It is also more important strategically, since it shares a border with anarchic Somalia, which America frets might be a breeding ground for terrorists. Meanwhile, two permanent members of the UN Security Council, Russia and China, are said to be selling arms to both sides.

Ethiopia's leaders are expert schmoozers. The prime minister, Meles Zenawi, for example, is a friend of Britain's Tony Blair. Eritrea's president, Issaias Afwerki, is less welcome in the corridors of power, not least because he has turned Eritrea into a military dictatorship. Some 300,000 Eritreans are in uniform, out of a population of 4m. Other industries are deprived of manpower at a time when they are also throttled by drought and the closure of borders with Sudan and Ethiopia.

Eritrea sorely needs hard currency to buy food, oil and, of course, weapons. Its main source is remittances from Eritreans living abroad, which used to account for more than half of GDP. The government tries to grab a share of these remittances through a rigged exchange rate. This naturally deters the remitters from remitting. But the government thinks force is the answer even to economic problems. This month, it threatened to jail anyone caught using foreign currency without permission. Mr Afwerki's courtiers try to justify the suppression of basic freedoms by arguing that their country is at an early stage of development. Without more freedom, however, it looks likely to stay there.

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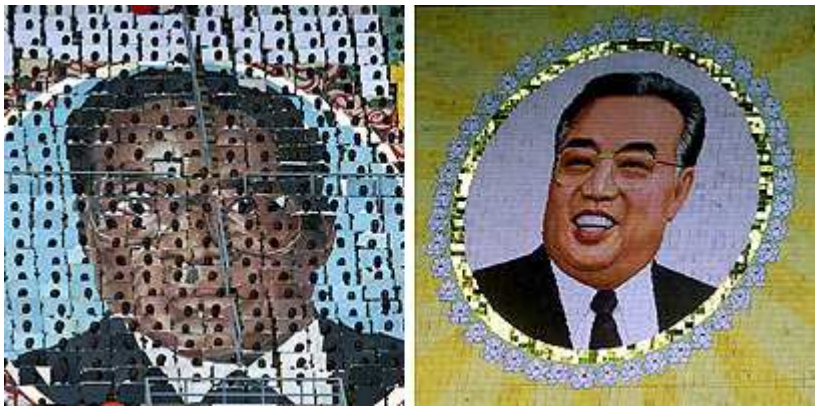
Great leaders think alike

Apr 21st 2005
From The Economist print edition

RTR/EPA



AT A rally this week, Zimbabwe's president, Robert Mugabe, said: “We have turned east, where the sun rises, and given our back to the west, where the sun sets.” Tigerish growth is nowhere to be seen, but Mr Mugabe's youthful supporters are gradually mastering the North Korean art of paying homage to the Great Leader with flip-cards.

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Correction: Human Rights Watch

Apr 21st 2005
From The Economist print edition

In our article last week about Côte d'Ivoire's latest peace deal, we said that a new International Crisis Group report recounted interviews with 60 itinerant mercenaries in the region. The report was actually published by Human Rights Watch. Sorry.

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The pope

Habemus Benedict XVI

Apr 21st 2005 | ROME
From The Economist print edition

Iberpress

Some Catholics are encouraged, some dismayed by the surprisingly quick election of a new pontiff

Get article background

IN HIS first utterance after being chosen to lead the world's 1.1 billion Catholics, Benedict XVI called himself a “simple, humble worker” for Christ. He was perhaps trying to allay doubts raised by the choice of a hard-line, German pope. He took the same course the next day when, celebrating his first mass as pontiff, he spoke of wishing to continue “the promising dialogue with other civilisations”.

Joseph Ratzinger is the son of a police officer from rural Bavaria. He served in the Hitler Youth and then in the Nazi Wehrmacht. That should not be of concern: his desertion in 1944 is evidence of a distaste for Nazism. Modest in his private life, the new pope has long lived in a small flat near the Vatican which, until her death in 1991, he shared with his sister. He has never been part of the social circuit in Rome that lures more worldly prelates. His gaze is often as open and innocent as it seemed when he stepped on to the balcony of St. Peter's on the evening of April 19th to acknowledge the cheering crowd.

Yet “simple” and “humble” are not words that spring to mind in assessing Benedict XVI. He is a master of that most subtle and casuistic of disciplines, theology. Under his predecessor, John Paul II, he headed the Congregation for the Doctrine of the Faith, the Vatican's “ministry” for maintaining orthodoxy, particularly among theologians. He did the job with a vigour and self-assurance that made him hated by liberal Catholic intellectuals. All the more so since Benedict XVI was once one of them. Like Pius IX in the 19th century, the new pontiff has traced a wide arc, from progressive to reactionary.

In 1962, when John XXIII set Catholicism on course for radical change, the young Joseph Ratzinger was among the theologians called to Rome for the second Vatican council. Four years later, he joined the theological faculty at Tübingen, recommended by a friend, Hans Küng, whose own progressive ideas later led to his being barred from teaching in the church's name. For the two Germans, as for so many, the watershed came with the student revolts of 1968. To some, they constituted a necessary, if boisterous, challenge to the complacent conservatism of post-war Europe. To the future pope they were the thin edge of the devil's cloven hoof: if unchecked, they could tip the continent into Marxism, atheism and chaos. Increasingly, the young theologian was questioning the need to question the fundamentals.

By 1977, when Paul VI plucked him from a professor's chair in Regensburg to install him in the archbishop's palace in Munich, he was perfectly in tune with the then pope's more cautious approach. He served for only four years before being called to Rome by the even more energetically conservative John Paul II.

A key point about the new pope is that he is a powerful intellectual who, unlike his predecessor, has led a relatively sheltered life. The quietly spoken Bavarian cannot be expected to deploy the profoundly human qualities that enabled Karol Wojtyla to spread a warm glow over severe doctrine. He may be as cerebral, but he is also less mystical. And for almost 25 years, Benedict XVI has been a bureaucrat.

That is not, of itself, a handicap. Many cardinals wanted a pope who understood the Curia, the church's administration. Only such a man, they argued, could break the grip exerted by the centralising John Paul II and restore to dioceses that operate in different cultural and political contexts a capacity for initiative and a margin of discretion. But any such shift can scarcely be expected from the man who helped John Paul II to homogenise Catholicism.

So what can be expected of the new pope? He himself gave a possible clue before the death of John Paul II, when he inveighed against the “filth” in the church “even among those...in the priesthood”. That suggests that Benedict XVI may tackle the paedophilia that has been rife among Catholic clergy with a determination sadly lacking in his predecessor. Yet, in other respects, he stands for little change. Not surprisingly, a conclave of cardinals almost all chosen by John Paul II opted for a candidate who promised continuity. And, not least, brevity. At 78, Benedict XVI, though in glowing health, is unlikely to have a long reign, unlike his predecessor. Yet he stands for the same take-it-or-leave-it form of Catholicism that he so skilfully helped his predecessor to define.

In Africa and Asia, people may take it, often as a bold, clear alternative to Islam. But in Europe, North America and, most significantly, in Latin America, Catholics are increasingly leaving it. A Chilean archbishop reminded the cardinals gathered in Rome that the Latin American church was losing followers at the rate of 1% a year. The Vatican's hostility to Latin America's “liberation theology” is partly to blame.

The views of the new pope, and his uncompromising way of expressing them, could make him a divisive force in rich countries as well. It is not just issues like birth control, married priests and women's ordination that divide Catholics. Aspects of Benedict XVI's thinking, such as his opposition to Turkey's accession to the European Union, have ramifications that go far beyond the church. Europe matters to the new pope, as the name Benedict suggests—Paul VI designated Benedict as the patron saint of Europe.

Letting the Turks into the EU, the then Cardinal Ratzinger said last year, would be “a huge mistake” and run “counter to history”. This shocked those eager to embrace the reality of a multicultural Europe. But it was music to the ears of those who identify Europe with Christendom. What worries some Turks about it is not that the new pope may be anti-Turkish or anti-Muslim,

but that he may, in a political sense, be anti-secular. If the pope's agenda is to reimpose religious authority over historically Christian countries, that could give heart to Muslims, in Turkey and elsewhere, who support “political Islam”.

A more optimistic view is that the new pope is a Christian Democrat in the modern, European sense: part of the political movement that draws inspiration from Catholicism but accepts the rules of the democratic game. Benedict XVI is certainly close to European Christian Democracy in one respect: his views on social and economic questions are well to the left of the Anglo-Saxon free-market consensus. He may surprise many by the vehement way he denounces global inequality, and seeks to prick the conscience of the rich. Nor will he be shy about denouncing bad government in the developing world.

As for the “democracy” bit, Cardinal Claudio Hummes of Brazil, a prelate once tipped for pope, said recently that the church should not impose its convictions and methods on society but strive instead “to propose and not impose, serve and not dominate.” In Brazil, as in many other places, people are waiting to see if the new pope will be so modest.

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Austrian politics

Haider fizzles

Apr 21st 2005 | VIENNA
From The Economist print edition

The far-right maverick forms a new party of his own

JÖRG HAIDER exploded on to the European political scene five years ago when his far-right Freedom Party joined the Austrian government. The coalition led by Wolfgang Schüssel, a moderate conservative, suffered the embarrassment of a diplomatic freeze by Austria's European Union partners, as well as upheavals caused by Mr Haider's erratic style. Now the government faces what may be an even more trying time. For the erratic Mr Haider has decided to dump his nationalist creed, desert his party and start another that steers clear of any recognisable ideology.

The Alliance for Austria's Future, as the new party is called, has adopted the colour orange from Ukraine's revolution. At its launch this week, Mr Haider managed to combine pro-European and anti-globalisation rhetoric. The man who once praised Hitler's employment policies now defines his credo merely as being “young, handsome and cool”.

Mr Haider had long been facing growing unrest from the Freedom Party's nationalist wing, as supporters blamed him for a string of electoral defeats and urged a return to his old populism. Being part of a moderate government has cost the party support: its backing peaked at 27% in 1999 but was down to no more than 9% by the start of this year. Mr Haider, now governor of Carinthia, seems more interested in the perks of power than in his old xenophobic message. He has toned down his anti-immigration rhetoric and even supports Turkey's entry into the EU.

By taking all Freedom Party ministers and most of his 18 parliamentary deputies with him into the new Alliance, Mr Haider can also keep Mr Schüssel in power. But most grass-roots activists are sticking with the old party. And the new one has not, so far, played well with the public. If elections were held now, the Social Democrats and Greens would probably win a majority; both the new Alliance and the old Freedom Party might fall short of the 4% threshold for parliamentary representation.

Mr Schüssel's hope is that he can hold his coalition together until the first half of 2006, when Austria holds the EU presidency, and use his formidable campaigning skills in the general election due later that year to keep his People's Party just ahead of the Social Democrats. Unless he can recapture his maverick appeal, Mr Haider's own political future looks likely to be short.

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Italy's government

A comic opera

Apr 21st 2005 | ROME
From The Economist print edition

The ins and outs of politics in Italy

Get article background

AP

Finger on the pulse

THE new pope is not the only leader whose future has been in the balance in Rome this week. Across the Tiber, Italy's prime minister, Silvio Berlusconi, handed in his resignation on April 20th, bringing to an end the longest-serving government in Italy since 1945. Not that Mr Berlusconi was planning to leave office. Under the constitution, a change of government is required before any big shake-up—which is what two of his key centre-right allies have been demanding for the past week.

At the root of the crisis was the centre-right's disastrous showing in Italy's recent regional elections. On April 3rd and 4th, it lost in all but two of 13 regional votes. This week, it was defeated in a 14th, Basilicata. Italy's voters are clearly telling the government it is on the wrong track. But the prime minister and his allies have little time left to find the right one. A general election is due by May 2006, and there is no sign that the dismal economy will improve much before then.

Mr Berlusconi still seems convinced that his existing policies will work, economically and politically, if given time. The centrepiece is his plan for the progressive reduction of income tax. The biggest cut, worth €12 billion ($16 billion), has been announced but not yet implemented. But his allies (to say nothing of the European Commission) are worried that these tax cuts cannot be afforded—and it remains to be seen if they will form part of a new government's programme.

The prime minister's first response to the regional elections was to propose a minor cabinet reshuffle. That was not enough for the Union of Christian Democrats (UDC), the third-biggest party in government. The UDC's leader, Marco Follini, one of Mr Berlusconi's two deputies, urged a clean break to show voters that the government was changing direction. With hesitant support from Gianfranco Fini, the other deputy prime minister and leader of the second-biggest coalition party, the formerly neo-fascist National Alliance, Mr Follini demanded that the prime minister resign, rewrite his programme, reshape his cabinet, and go back to parliament for a fresh vote of confidence. When Mr Berlusconi refused, the UDC leadership said on April 15th that it would pull out of the cabinet, though it would continue to support the prime minister in parliament.

After a hectic weekend, Mr Berlusconi agreed, at a meeting of party leaders, to hand in his resignation to President Carlo Azeglio Ciampi. He set off to do this, only to emerge with an impish grin and a statement that he had changed his mind. His about-turn snapped the patience of Mr Fini, who said that he would pull his party out of the government unless Mr Berlusconi gave way.

This battle has been largely over tactics, but the surface hides layers of substance. One question is the real aim of the UDC, long the most suspect of Mr Berlusconi's allies. The earthquake that shook Italian politics in the early 1990s scattered the Christian Democrats into rival camps. Mr Follini and his friends sided with Mr Berlusconi; others chose to ally with the left. The prime minister's followers have long feared that Mr Follini's ambition is to reunite the wings of Christian Democracy into a movement that could recapture the middle ground—perhaps after a Berlusconi defeat and a spell in opposition.

Italy's halting progress towards a more liberal economy and a two-party, or at least two-sided, democracy on Anglo-Saxon lines may thus be in question, since both would be blocked by the re-creation of an all-embracing Christian Democrat party. The UDC, like the National Alliance, is rooted in the poorer, more welfare-dependent, south where fears about Mr Berlusconi's agenda have been heightened by another part of his programme: a constitutional reform that would boost the autonomy (and also the resources) of the richer, more entrepreneurial north.

Although it may not seem like it at first, Italy's political crisis in part reflects the wider debate over how far to go in replacing Europe's social model with American-inspired free-market principles. The debate has real substance. Not that that will stop Mr Berlusconi thinking Mr Follini is a rat. Or Mr Follini from fearing that he may be re-boarding a sinking ship.

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Spain and the Basques

Basque blues

Apr 21st 2005 | BILBAO AND SAN SEBASTIAN
From The Economist print edition

After the regional election, a chance for a deal with Madrid?

Get article background

THE Basque premier, Juan José Ibarretxe, had hoped that the regional election on April 17th would give him a new mandate for his plan to move closer to independence. Instead, his Basque Nationalist Party (PNV) lost four seats, leaving it well short of a majority. Spain's Socialist government in Madrid, heartened by a gain of five seats for the local Socialist party, making it the second-biggest in the region, declared that Mr Ibarretxe had failed in his aim. In a low turnout, the PNV, which has been in power for 25 years, lost 140,000 votes from its 2001 tally.

“The Ibarretxe plan has been defeated democratically...[it] is now part of the past,” announced José Blanco, a leading local Socialist. The plan was narrowly approved by the Basque parliament in December, but rejected by the Cortes in Madrid in February. Mr Ibarretxe promptly called elections a month early, hoping the masses would rally to the cause. The questions now are: why did his plan not prosper, and is it really dead?

Few voters understood the Ibarretxe plan. Some PNV members said it was too ambitious; others that it did not go far enough. But another reason for the PNV's performance was that it failed to win voters away from Batasuna, the banned political wing of the ETA terrorists. Arnaldo Otegi, Batasuna's leader, seems to have pulled off a master-stroke. After the courts stopped a surrogate party from standing as a Batasuna front, Mr Otegi told supporters to vote for the (almost unknown) local Communist Party. Despite the Communists' close ties to Batasuna, the courts could find no reason to ban them; they won over 12% of the vote and nine seats, two more than the (pre-ban) Batasuna in 2001. The opposition People's Party (PP) criticised the prime minister, José Luis Rodríguez Zapatero, for letting ETA survive politically. “ETA is going to shape political life and that is very discouraging,” said Maria San Gil, the PP's local boss.

There will now be months of horse-trading, as the PNV looks for a workable coalition. Mr Ibarretxe may form a minority government in alliance with his current partner, the United Left, plus Aralar, a Batasuna splinter that advocates Basque independence but rejects ETA's terrorism. But that would still give him only 33 seats in the 75-seat assembly, the same as the Socialists and PP combined. Or Mr Ibarretxe could link with the Communists, which would give him a majority but make it harder to negotiate with Madrid.

A more intriguing possibility is an informal pact with the Socialists. During the campaign Mr Zapatero said that he was prepared to negotiate a new constitutional deal acceptable to a broad majority of Basques, and would put it to a referendum if it won two-thirds backing in the Basque parliament. In this way the Ibarretxe plan could survive in mutated form, perhaps shorn of some demands for national recognition and autonomy. Indeed, many local commentators sense a new optimism.

The sources of this optimism are the “Zapatero effect”, the prime minister's almost tiresome

willingness to negotiate, plus the fact that Batasuna and ETA have a new desire for peace. ETA has not killed for two years. For the first time in decades the elections were free from violence. Mr Zapatero repeated this week that it was time for solutions. Mr Otegi talks of a deal short of breaking away from Spain that involves “the recognition of the Basque nation and our right to self-determination”.

Josu Jon Imaz, the PNV president, insists that there is now an historic chance for an accord. His party wants a broad agreement on a peace process and constitutional reform. Consciously using the language of Northern Ireland's Good Friday Agreement, he says that “we have to accommodate everybody”. But will an Imaz plan be any more successful than the Ibarretxe plan when it meets reality?

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Cyprus and Turkey

Talat ho!

Apr 21st 2005 | ANKARA
From The Economist print edition

A helpful election, but problems still ahead for Turkish Cyprus—and Turkey

Get article background

AFP

Talat's victory signal

AFTER leading the Turkish Cypriots for over three decades, Rauf Denktash, the mulish president of the self-proclaimed Turkish Republic of Northern Cyprus, is at last stepping down in favour of his determinedly pro-European rival, Mehmet Ali Talat. Mr Talat easily won the presidential election on April 17th, on a platform of reuniting the divided island and joining the European Union. The departure of Mr Denktash is being hailed by pro-peace Turks and Greeks as a step towards ending Cyprus's 30-year-old division. For years Mr Denktash (with help from like-minded hawks in Ankara) had torpedoed all United Nations plans for a settlement, earning him the nickname “Mr No”.

But can Mr Talat, an engineer who once made a living from repairing fridges, make a difference? Despite welcoming noises from Ankara, Brussels and Nicosia, few observers think he will do so quickly. The island's wealthy Greek-Cypriot majority voted massively against the latest UN plan last April, and waltzed into the EU as the Turkish-Cypriots looked on. With recent opinion polls showing that three-quarters of his people continue to oppose the UN blueprint, the Greek-Cypriot president, Tassos Papadopoulos, is in no hurry to return to the negotiating table.

In Turkey itself, the picture looks even murkier. Last week, Recep Tayyip Erdogan, the prime minister, alarmed EU diplomats when he told pro-Islamic businessmen that the EU was engaged in “efforts to dismember” Turkey. With a spasm of nationalist violence erupting across Anatolia (aimed in some cases against Kurds), and with polls showing falling support among Turks for EU membership, Mr Erdogan's words have raised new questions about his commitment to joining the EU.

Ominously enough, the chief of the general staff, Hilmi Ozkok, leapt into the fray this week, reminding an audience of Turkish cadets that Cyprus, where Turkey retains some 30,000 troops, is of “strategic significance”. He warned the Greek Cypriots that they would not be permitted to use their membership of the EU to extract further unilateral concessions from Turkey. This despite the fact that, braving cries of treason in opposition circles, the government agreed last year to formalise relations with all ten of the EU's new members, including Cyprus, as a condition for its own entry talks to begin on October 3rd.

An intra-EU legal wrangle has delayed implementation of the deal, preventing the long-promised easing of trade and air-travel restrictions on the Turkish Cypriots, and adding to frustration among Turkey's leaders. Meanwhile Mr Denktash has made clear that he will pursue his campaign of

obstructionism from beyond the presidency. Mr Talat may yet find himself yearning for the days when he dealt with simpler things, such as fridges.

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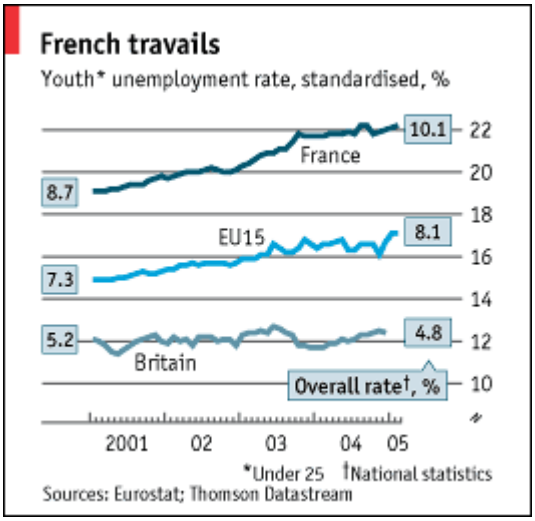
French unemployment

Not working

Apr 21st 2005 | PARIS
From The Economist print edition

Why France's unemployment is proving so intractable

Get article background



IT IS early on a Friday, and the job-centre on the Rue Damrémont, on the northern fringes of Paris, is humming. Job-hunters browse offers pinned to the wall; others search on the internet. Massou, leafing through a folder of ads, has been looking for kitchen work—cleaning or dishwashing—for eight months. Previous jobs, as a security guard and at a printing works, were short-term only. “I've sent 20 CVs, but nobody has called me for an interview,” he says. Faker, 29, is also looking for restaurant work, but says most ads are for part-time or temporary jobs. Even for those, he has had no offers in two months. “When I ring, they say the job has gone.”

After dipping to 8.3% in 2001, unemployment in France has since been creeping relentlessly up. It hit 10.1% in January, well above the pre-enlargement EU average of 8.1%, and over twice Britain's 4.8%. For under 25s, unemployment is now over 22% (see chart). Worries about jobs, especially among the young, underlie much of the dislike of President Jacques Chirac's government, which faces a testing referendum on the draft EU constitution on May 29th. A new back-to-work plan is being implemented. But will it be enough?

The government has at least grasped the importance of the problem. Jean-Pierre Raffarin, the prime minister, has promised to trim unemployment by 10%. Jean-Louis Borloo, minister for social cohesion and former mayor of the industrial town of Valenciennes, has pushed through a new law to revamp welfare and job schemes. Much of it is sensible and overdue. The public job-placement agency, ANPE, will face competition for the first time: at present, the private sector can offer only temping. New *maisons de l'emploi* (job-centres), loosely modelled on the British variety, will bring together recruitment, benefit and welfare services. By 2009, the number of apprenticeships will be increased by nearly 40%, to 500,000 a year. Over the next five years, a million people on welfare will be offered training and subsidised jobs. New fiscal incentives should help to create 500,000 domestic-service jobs over three years. The idea, says Mr Borloo, is to deal with labour-market “dysfunction”, and so reduce structural unemployment.

Implementing all this, however, is particularly complicated in France. The government does not run unemployment insurance. This job falls to Unedic, which is co-managed by employers and workers, who jointly set rules on entitlements, based on personal contributions. These are hugely generous: the top monthly allocation, dictated by previous pay, can be as high as €5,700 ($7,420), against £243 ($466) in Britain. Meanwhile the government finances welfare for those without insurance rights, as well as job-placement. The upshot is fragmented, and inefficient.

Getting the various agencies to work together is hard. Unedic and ANPE are currently squabbling over how to police benefit claims. Jean-Pierre Revoil, head of Unedic, told *La Tribune* this week that France had developed a “welfare culture” that needed tighter controls. In the new job-centres, it is unclear who will patrol the take-up of the new work schemes—or how tough they should be. “The system is voluntary,” says Mr Borloo, who argues that abuse is exaggerated. “We are not looking at suspension of benefits.”

Why does the government need such ambitious job schemes in the first place? Employment policies already cost €70 billion a year, yet they have done little to dent unemployment. Nor, Mr Raffarin has conceded, is it likely to shrink much before next year. The harsh answer is that the welfare system is not the real problem.

Economic growth in France is job-poor. In effect, the French pay a price for the protections—a high minimum wage, security from lay-offs, a short work-week—that those in permanent full-time work enjoy. In labour-intensive sectors, France has become highly automated, and many new jobs are temporary. A Unedic survey shows that around one-third of the jobs employers expect to create in 2005 will be short-term. This introduces flexibility, but it also creates a two-tier system: comfortable, sheltered jobs for some; precarious, temporary ones for others.

Young job-seekers tend most often to be excluded—hence their anxiety. Asked on television last week why Britain's unemployment was so much lower, Mr Chirac replied that its social rules would be “unacceptable” in France. In the Rue Damrémont, that falls flat: what is unacceptable is not being able to find a job.

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Charlemagne

The great unravelling

Apr 21st 2005
From The Economist print edition

A French no would lead to a nasty period for the European Union

"THERE is no plan B" may be the most hackneyed phrase in the Brussels lexicon, trotted out whenever any EU scheme runs into trouble. But when it comes to the growing possibility that French voters will reject the new EU constitutional treaty in a referendum on May 29th, it rings true: there really is no plan B, or at least none that makes much sense.

Getting the constitution through was always going to be hard. It must be ratified by all 25 EU countries before it can come into force. But all the plan Bs so far have envisaged rejection by a small country, like Denmark, or a semi-detached one, such as Britain. A French *non* would be different. France was one of the six countries that got the European project going in the 1950s. Robert Schuman and Jean Monnet, two Frenchmen, are seen as "founding fathers" of European unity; another, Jacques Delors, as the most successful European Commission president to date; yet another, Valéry Giscard d'Estaing, chaired the convention that drafted the constitution. The French, unlike the British (or Danes), have adopted the single currency, the euro.

Despite all this, a string of opinion polls suggests that the no campaign is well ahead in France. President Jacques Chirac's intervention in the debate on April 14th, in a televised discussion with youngsters, has backfired, with the no vote gaining ground afterwards. A French rejection could also trigger a Dutch no in their referendum just three days later. Such a double blow would not only hit believers in "ever closer union". It would also present some huge practical problems.

Faced with these, the new buzzword in Brussels is "de-dramatisation": stay calm and stick together. The EU can keep functioning on the basis of its current rule-book, set out in the Nice treaty and its predecessors. Some may argue for pressing ahead with the ratification of the constitution (six EU countries have already passed it, with Greece doing so this week), in the hope that the document might yet be saved in some way. In the past, countries that rejected a treaty have been offered a few concessions and prevailed upon to vote again. But France is too big, and French objections to the constitution too large and inchoate, to be treated like this. Anyway, if the French could not get a constitution they liked from a convention that took place before EU expansion and was chaired by a former French president, it is hard to see how they could get a better one now.

If it were accepted that the constitution had been killed off, attention would turn to various clever technical fixes. Many of the constitution's provisions, such as a new EU diplomatic service, could be prised out of the document, and adopted by simple agreement between heads of state. Changes in the EU's voting system, or the abandonment of national vetoes over various EU policies, which clearly require changes to existing treaties, could then be put in a new slimmed-down document ("just one page", says a Brussels optimist) and pushed through national parliaments, with no need for pesky referendums.

Legally, all this might be possible. But it would ignore the new and unpredictable political mood that would surely follow from a French no. Fed up with the economic and political consequences of

EU enlargement, France might be tempted to push for a radical reorganisation of the EU around the original six members. A country that is into its fifth republic would have no fear of a second EU. But the difficulty with French day-dreams of this sort is that, after a referendum failure, Mr Chirac would be too enfeebled politically to launch any such initiative. And the Germans, France's indispensable partners, might anyway be disinclined to follow him.

France might instead lapse into a long-term obstructionism that would make Britain look like a model European. After the French National Assembly rejected the European Defence Community in 1954, it took almost four decades to revive the issue of defence co-operation. A backlash against more EU enlargement could also follow. Plans for membership talks with Turkey in October might be put on hold. Even Bulgaria and Romania, with which the EU has now signed accession treaties, might be victims: their membership still has to be ratified by France.

The other great French bugbear, during the referendum campaign, has been “ultra-liberalism” being pushed in Brussels. Anything that looked like further liberalisation—above all the hated “Bolkestein directive” freeing trade in services—would surely run into ferocious French opposition. EU budget negotiations would also be tougher, with France determined both to hang on to farm subsidies and to scrap the British budget rebate.

The project unravelled

In Brussels, the gloomy talk is of a “period of stagnation”, after a French no. That is the most plausible outcome, and few EU citizens would notice the difference. But there is a worse possibility: that the EU might begin to break down. National governments, many of them in serious economic difficulty, might be tempted to seize on the unpopularity of the EU and ignore inconvenient edicts from Brussels. This process is well established for the euro. Germany and France have persistently breached the rules on budget deficits; deficits in Greece, Italy and Portugal are all soaring. This unravelling of EU discipline over the euro might spread to other areas.

True believers might bemoan this trend, but they may have only themselves to blame. Eurosceptics have long predicted that deeper integration based on shallow popular support would spark a backlash. And not just Eurosceptics. A year before the constitutional convention met, Frits Bolkestein, then a European commissioner, commented that “it would be a risky business to work towards a federal Europe, since there is a good chance of failure and Europe might then end up on the road to disintegration as a kind of reaction.” Perhaps the French should have listened to Mr Bolkestein, after all.

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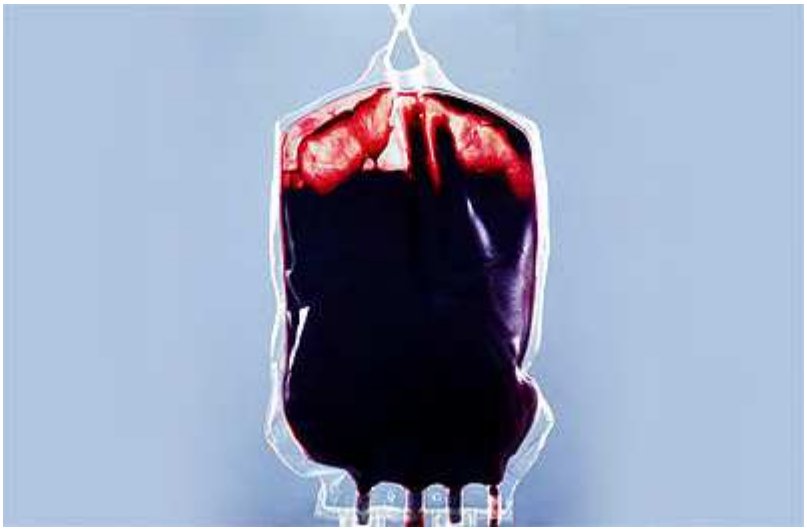
Economist.com WORLD EUROPE

Health

New blood for the health service

Apr 21st 2005
From The Economist print edition



How Labour's reforms are beginning to make the NHS work better

Get article background

THE health service has featured surprisingly little in the election campaign. At first sight, that seems odd, since health is almost always at the top of the public's list of concerns. What's more, the National Health Service (NHS) has swallowed up the biggest chunk of the extra money the government has spent on public services since 2000, yet most people are still dissatisfied with it (see chart).

Given public disappointment, Labour has reason to avoid the subject. But so, curiously, do the Tories. Although the public is disappointed with the lack of progress, Labour is still more trusted on the NHS than any other party. What's more, although they dwell on small differences, the opposition parties agree with the basic direction that Labour has set for the NHS. And that direction offers real promise.

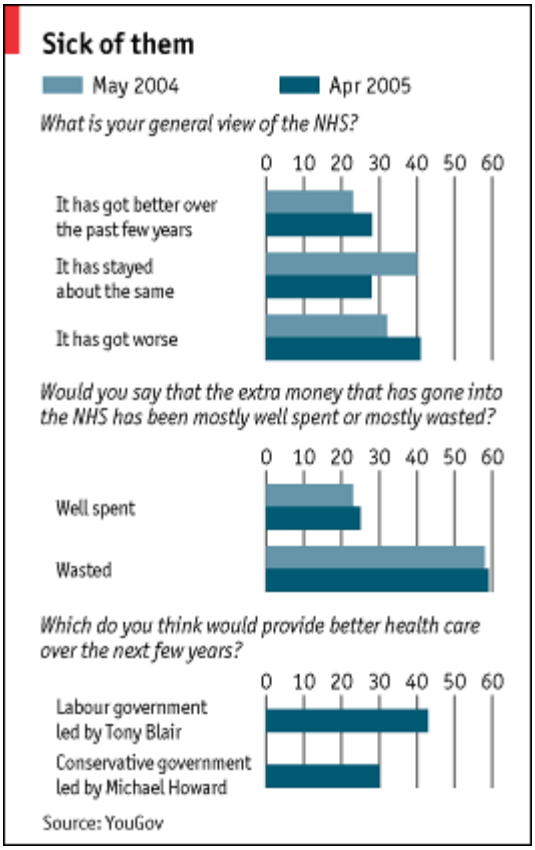
Labour spent its first term dismantling the internal market the Tories introduced. It also started to pour cash into the NHS. But by its second term, it realised that reform was needed as well as money, so it reinstated and extended reforms.

Homerton University Hospital, based in Hackney, a poor

part of East London, shows where the NHS is now heading. For one thing, it is a foundation trust—a reform that led to a bitter row within Labour's ranks in the last parliament. Foundation trusts have greater freedom to run their own affairs than do other NHS hospitals. They are subject to scrutiny by locally elected governing bodies; and a new regulator called Monitor oversees them with a particular focus on their finances.

This April, another six trusts got foundation status, taking the total to 31 out of the 173 acute-care trusts in England. At Homerton, one of the first wave of ten trusts to win foundation status a year ago, the reform has led to a sharper focus on the trust's finances. “There is much more financial awareness, especially of our responsibility to control costs,” says John Coakley, the medical director. “It has led to a greater rigour about our plans and their financial implications.”

As a foundation hospital, Homerton is already feeling the impact of an even more far-reaching reform. The hospital trust used to get its money through a block grant that was only loosely linked to how much work it did. But under a new system of payment by results, about 70% of its budget is tied directly to its activity, with treatments priced according to a national tariff based on average hospital costs.


Sick of them
May 2004
Apr 2005
What is your general view of the NHS?
0 10 20 30 40 50 60
It has got better over the past few years
It has stayed about the same
It has got worse
Would you say that the extra money that has gone into the NHS has been mostly well spent or mostly wasted?
0 10 20 30 40 50 60
Well spent
Wasted
Which do you think would provide better health care over the next few years?
0 10 20 30 40 50 60
Labour government led by Tony Blair
Conservative government led by Michael Howard
Source: YouGov

“Payment-by-results is much more significant than moving to foundation status,” says Mr Coakley. The new payment system is already concentrating minds. “We didn't really understand our cost base before and now we have to,” says Caroline Clarke, the trust's finance director. For example, the reform has highlighted the expense of unnecessarily long hospital stays.

The new payments system forms part of a policy U-turn by Labour. The internal market that the Tories introduced in the 1990s gave general practitioners (GPs) budgets to purchase care for their patients. Now larger organisations called primary care trusts (PCTs) do the purchasing. “The new payments system restores the internal market with whistles,” says John Appleby of the King's Fund, a health-policy think-tank. Labour's internal market covers a bigger chunk of hospital budgets and has sharper financial incentives.

In another crucial reform, Labour is complementing the internal market with an external one. It is encouraging private providers to carry out work for the NHS. This year, around 4% of elective (non-emergency) treatments will be done by private providers and Labour wants this to rise fast, towards 15% of elective work.

Homerton has decided to expand. It is investing in a perinatal centre that will provide facilities for premature babies and their mothers. This will cost £6m ($11.5m), a sizeable amount to borrow on a turnover of £130m and a capital base of £100m. This would probably have happened under the previous regime, says Ms Clarke, but it is happening a lot faster because the hospital is a foundation trust.

Will Labour's reforms work? Already, the planned extension of payment-by-results this April to other acute-care hospitals has been restricted because of worries that it was going to cost too much money. The original intention had been that the payments system would cover most

activity, but it will now apply only to elective care. Ms Clarke says that “the tariff is still very unstable”, and suspects that more work needs to be done on getting the prices for treatments right.

A bigger long-term worry is about the balance of power between the purchasers of care (the PCTs) and the sellers (the hospitals). “PCTs are the weak link in the chain,” says Mr Appleby. If they are too weak, they'll end up paying hospitals too much. Responding to this concern, Labour is now seeking to involve GPs more directly. Gabriela Tobias, a GP in Hackney and a member of the local PCT's professional executive committee, welcomes the change. “Together with payment by results it provides a real opportunity to get investment into primary care where patients can often be treated more cheaply and effectively,” she argues.

Labour's reform programme lacks nothing in ambition. While largely untested, the reforms mean that the health service is at long last getting the right medicine. At great expense to the taxpayer, Labour has learnt that markets matter more than cash in improving the NHS.

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Economist.com WORLD EUROPE

Immigration and politics

Race war

Apr 21st 2005 | BASILDON AND UPMINSTER
From The Economist print edition

The unseemly scramble for the anti-immigrant vote

FEW black or brown faces can be seen in Basildon, a town on London's eastern fringe, but the natives still feel under siege. Locals blame “the tourists”, as immigrants are known, for unemployment and the difficulties of securing public housing. According to David Harris, a builder, immigration is by far the most pressing issue for the forthcoming general election. In last year's local elections, he voted for the British National Party (BNP), a far-right outfit that campaigns for the repatriation of non-whites. One in five people in his district did the same.

But Mr Harris will not be voting for the BNP next month. Local elections do not matter much, he explains, but in a general election it is important to vote for a party that might be able to put an anti-immigration policy into action—namely, the Conservatives. Others agree. As Lee Wade, an unemployed man who also intends to vote Conservative, puts it: “It would be great if the BNP got in, but you've got to vote for someone who has a reasonable chance of winning.”

In the “white flight” districts on the border between London and Essex, the anti-immigrant vote is fiercely contested. The BNP, which emerged from the National Front in 1982, used to monopolise the issue. But in this election, the Conservatives are touting quotas for immigrants and the offshore processing of all asylum-seekers, while the UK Independence Party (UKIP) promises “freedom from overcrowding” and an end to economic migration. “They're thinking what we're thinking,” notes Phil Edwards, the BNP's national press officer.

One clue to how support may flow between the parties was provided by last year's London mayoral elections, where (unusually in British politics) people were given two votes. Of those who selected the BNP's candidate as their first choice, 49% cast their second ballot for UKIP and 22% chose the Conservatives. Those who preferred UKIP gave 22% of their second-choice votes to the BNP and 36% to the Tories. Conservative voters did not reciprocate nearly so generously, suggesting they were more focused on stopping the re-election of Labour's candidate, Ken Livingstone, than in protesting. Just 7% cast their second-preference votes for the BNP.

Few people stand to suffer more from an outbreak of right-wing tactical voting than Chris Roberts, the BNP's candidate in nearby Upminster. He has to contend not just with UKIP but also with the Third Way, a local group that describes itself as a “patriotic centre party”, and with a Tory incumbent who used to be a member of the right-wing Monday Club.

The irony that someone who campaigns against the overcrowding of Britain should find himself uncomfortably cramped on the political right is lost on Mr Roberts. He believes the media have talked up UKIP as a ploy to draw votes from the BNP. As for the Conservatives, Mr Roberts claims they are jumping on the anti-immigration bandwagon; they are also hypocritical, he says, having done little to stem the tide during 18 years in power.

The Tories may not have stopped the influx, but they did stop the far right. During the 1970s, the National Front steadily gained support, standing in a growing number of constituencies and

winning an average of more than 1,000 votes per candidate. In 1979, the party contested half of the seats in Britain. But it was swept away by a Conservative Party that made an explicit appeal to anti-immigrant sentiments, and four years later the party was defunct.

In this election, the BNP is standing in more constituencies than ever before and facing a Tory party that is campaigning hard on immigration. If history repeats itself, it will not be a great pity.

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Iraq and the election

Polite protest

Apr 21st 2005 | BRISTOL WEST
From The Economist print edition

Where the Iraq war matters most

A GOVERNMENT takes the country into an unpopular war and its main reason for doing so turns out to be hooey. Voters watch British soldiers getting blown up on television and then tune in for the execution of a civilian, who appeals to the prime minister to save him—and then has his head severed with a small knife. Most people now disapprove of the war, but when asked how important Iraq will be in deciding how to vote, they shrug: a recent MORI poll for the *Evening Standard* placed Iraq 14th on a list of 16 electoral issues, well below education and health care and about level with Europe and animal welfare.

Why is this? First, foreign policy tends to be a peripheral concern in British elections. This time, the Iraq war has merged with domestic political concerns, feeding dissatisfaction with the government and a dislike of Tony Blair. Second, the 1.5m Muslims in England and Wales are not numerous enough to shape the overall result, though their votes may prove decisive in a small number of constituencies such as Leicester South, which the Liberal Democrats took in a by-election last year.

But the Lib Dems hope that their anti-war stance will pay off in some seats very different from the poor city constituencies where new migrants settle. Iraq resonates most with richer voters. According to polling by Populus, 55% of ABs (the top social group) disapproved of the way that George Bush handled Iraq compared with just 40% of DEs (the bottom group). The Lib Dems hope that in Labour-held Bristol West, which is one of the few three-way marginal seats, an affluent, well-educated and left-leaning electorate will desert Labour over the war.

Stephen Williams, the Lib Dem candidate, visited 22 curry restaurants last Sunday to shore up support among the constituency's 1,500-strong Bangladeshi population. On April 15th he was canvassing outside a small, crowded mosque. The mosque has become so popular that the Pakistani imam, who wears a long beard tinged with henna, is looking to take over a nearby Irish pub and replace the bar stools with prayer mats. “You'll get six votes from me,” one paterfamilias assures Mr Williams, who looks rather uncomfortable about receiving votes in bundles.

But the Lib Dems know that there are not enough of these voters to carry a seat where only 7% of the population is non-white and many of the ethnic minorities are of Afro-Caribbean origin. Instead, they hope that anti-war feeling will prevent a repeat of the pro-Labour tactical voting that reduced their total in 2001. If the strategy works, though, it will be thanks to the ABs in Georgian and Victorian terraces, rather than the Muslim vote.

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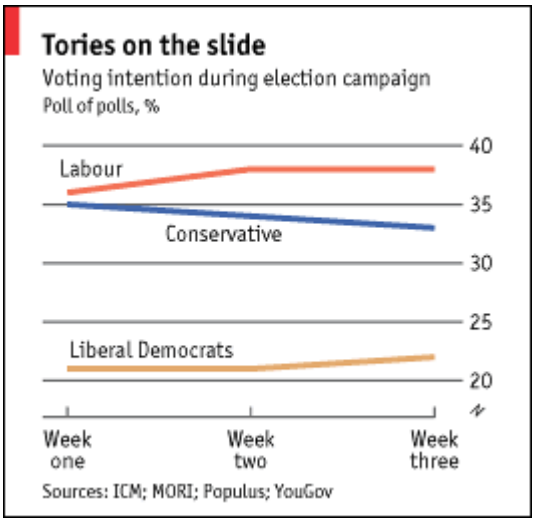
Campaign diary

On the trail

Apr 21st 2005
From The Economist print edition

Charlie clears things up

"Again, the IFS have said, looking...casting their slide rule over our proposals...you're talking in the region of tw...twent...yeah, I mean, if you take a double income, say, a double income couple, err, £20,000 each, that's what you're talking about. Yep, £40,000, sorry, yes." Lib Dem leader Charles Kennedy explains who would pay more under his party's local income tax.

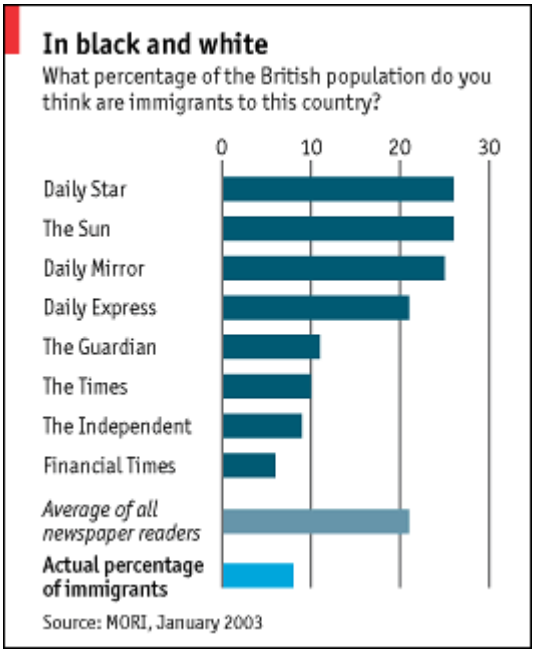


60% choose hellfire

"Voting for any political party which has a policy of legislating law is *Kufr Akbar* (major apostasy) and will take you outside the fold of Islam—regardless of your intention to vote. It will also nullify all your good deeds (if you have any) and guarantee your seat in Hellfire forever!" Voting tips from the Saviour Sect.

Respectfully yours

"An eminent diplomatic and intellectual person." George Galloway, ex-Labour MP and figurehead of the Respect Party, pays homage to Tariq Aziz, once Saddam Hussein's right-hand man.



Read my lips

"This is obviously just a typographical error." A Labour spokesman explains why, in a leaflet on health policy, the party said it decided to raise National Insurance in 1998. Labour has long asserted it decided to put the tax up only after the election in 2001.

Yew and non-yew

"Box hedges here. Sure sign of Lib Dems." Boris Johnson, Conservative MP for Henley, eschews his party's voter identification software and pays attention to the topiary.

Aesthetes against Labour

"Across the country, housebuilding is booming. The question for voters is: has Labour done enough to steer it towards quality and away from the brick-box blight on our lives?" *Building Design* raises the key electoral issue as polling day approaches.

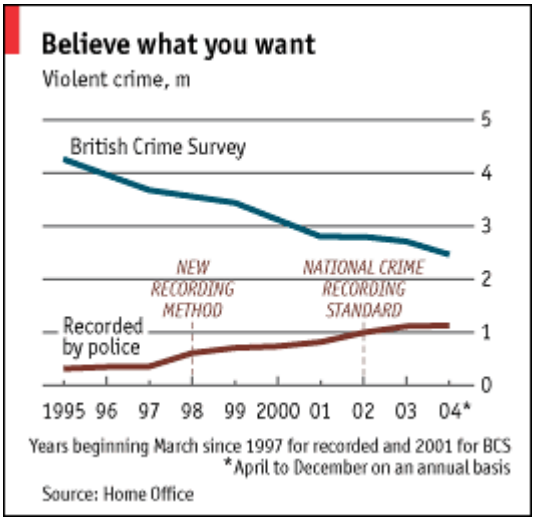
Crime

Up or down?

Apr 21st 2005
From The Economist print edition

An argument over the true level of crime, not how to cut it

Get article background



VOTERS in the forthcoming general election may find it hard to spot the difference between the crime-fighting agendas of the three biggest political parties. All want less paperwork, more officers on the streets and greater public scrutiny. When it comes to the seemingly straightforward issue of how much crime is occurring, though, the consensus disappears. According to Labour's manifesto, crime is down by 30%. Not so, say the Tories: crime has risen 16% since 1998-99, and violent crime is up by more than 80%. Who is right?

Neither, according to Marian Fitzgerald, a University of Kent criminologist. The Conservatives have used police statistics in a “mischievous and disingenuous” manner. Labour has mostly ignored those figures and has plumped for the British Crime Survey, which measures people's experiences but fails to capture some offences—notably, crimes against children.

The two measures tell very different stories, particularly when it comes to violent crime (see chart). Figures released on April 21st added to the confusion: recorded violent crime rose 9% in the past year, while the British Crime Survey showed a fall of 10% in violent crime.

The main reason is that the police have twice changed their methods of recording crimes. They began to tally a wider range of offences in 1998, and then, in 2002, adopted an experiential definition of crime. An assault is now an assault if the victim says it is, regardless of what coppers think. An attack on three people is now three incidents and not one, as it usually had been before.

The government's problem is that it failed to foresee how dramatically these reforms would affect the numbers of crimes recorded by the police, or how long it would take many coppers (notably those in London) to change their ways. A sudden rise in recorded crime could have been explained away; a lurching, protracted escalation is harder to justify.

Other changes have further inflated the police figures, according to Mike Hough, a criminologist at King's College London. The police are showing more interest in crimes that were previously under-recorded, which makes no difference to the British Crime Survey but pushes up the police figures (recorded rapes of men increased from 150 in 1995 to 893 in 2003-04, for example). The police are also under pressure to bring more offenders to justice, meaning they are less likely to overlook petty misdemeanours.

Perhaps most important, there is a record number of officers on the streets. With all measures showing a decline in burglaries and car crimes, they can spend more of their time cracking down on drunken rowdiness in city centres. Given the parties' pledges, that is likely to continue. None seems to have noticed that, by promising to put more police on the streets, they make further, embarrassing rises in recorded crimes almost inevitable.

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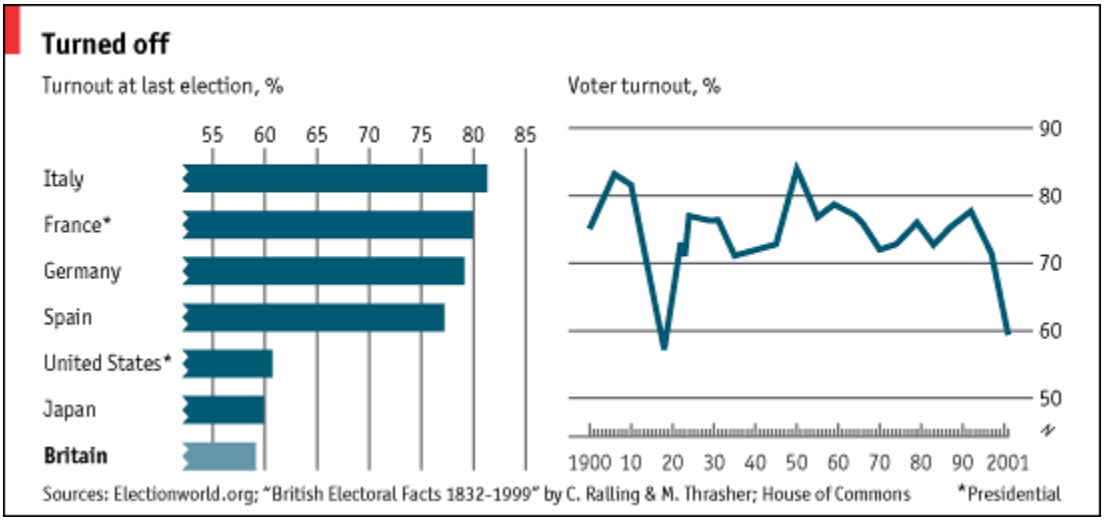
Election turnout

What makes people vote

Apr 21st 2005
From The Economist print edition



A closer race, but still not much choice

IS ANYONE listening? The answer matters just as much as who's up and who's down in the latest poll.

At the 2001 election turnout plummeted to 59%, 12 points down on 1997 and lower than at any election since 1918. Britain's political class is united on one thing: worrying about voter apathy and disengagement. If most voters stay at home, no government can plausibly claim a mandate from the people.

It's not that people have suddenly got bored by politics. Last week MORI, an opinion pollster, found that 61% say they are “very” and “quite” interested in politics, as high a level of interest as at any time over the last 30 years. Interest in politics, however, is not enough to get people to the polling station. They have to feel there is a real choice on offer too.

Last time around many voters didn't see it. According to the British Social Attitudes survey, only 17% reckoned there was a great deal of difference between the Conservatives and Labour, fewer than at any time since the question was first asked in 1964. At the same time they were also being told by the opinion polls—uniquely, for the second time in a row—that Labour couldn't lose. As a result only the dedicated went out to vote as normal.

Thus turnout on May 5th is likely to depend both on how much choice voters think they have and on how close they reckon the result will be. In February an NOP poll found that only 21% thought there was much difference between the parties. However, since the campaign began, the Tories' tough anti-immigration pitch may have polarised voters.

This also appears to be a closer contest than in 2001. Labour's average poll lead is currently only five points, well below the 14-point lead it had at the end of the last campaign. During the first two weeks of the 2001 election campaign, ICM asked people to say, on a scale from one to ten, how certain they were to vote. Only 54% gave themselves a score of ten. In the first two weeks of this campaign MORI and NOP have on average found 59% with that score, and Populus 56%. Only ICM currently still puts the figure as low as 54%.

Such figures are not enough to suggest turnout will return to the 70%-plus level that used to be the norm. Rather, 65% would seem to be the best that can be expected, boosted in part by an increase in postal voting. Until voters think they are being asked to do more than choose between Tweedledum and Tweedledee, it's unlikely to get much better than that.

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The campaign

Mr Knight and Mr Nice

Apr 21st 2005
From The Economist print edition

A close, but not very fierce, contest

DORSET, the prettiest bit of England, is also one of the election's most closely fought battlegrounds. Its four constituencies are all marginal. The Tories are defending two seats from a strong Liberal Democrat challenge. They lost the other two in 2001, one to the Lib Dems and one to Labour, and are struggling to regain them.

South Dorset, where Jim Knight won by 153 votes, has the distinction of being the tightest Labour marginal in England, while Oliver Letwin, the shadow chancellor, who holds West Dorset, is one of the big Tory names the Liberal Democrats have targeted with their “decapitation strategy”.

Even with their poor current poll ratings, the Conservatives should hang on to West Dorset, but Mr Letwin is taking no chances. Torn between his role in the national campaign and the need to save his seat, he is driven two-and-a-half hours to and from his constituency every day.

In torrential rain, he works his way diligently through Litton Cheney, Askerswell and Loder. He is terribly nice and so are nearly all the people who come to their doors, even the husband of Gordon Brown's mother-in-law. Mr Letwin is almost too polite to ask them to vote for him and nearly all are too polite to hint that they might do anything else. When he has the good luck to stumble on members of the local Women's Institute setting up a bring-and-buy sale in a village hall, everyone is giggly and terribly friendly, but the conversation is confined to the awfulness of the weather.

Things may get rougher when Mr Letwin descends on Dorchester and Sherborne, where the Lib Dems are concentrating their efforts. A few debates between the candidates have been lined up, which Mr Letwin expects to be “lively affairs”. But still jolly polite. Mr Letwin has yet to meet his Lib Dem foe, Justine McGuinness, but he gathers she is “very nice and fighting a very dignified campaign”.

Perhaps the UK Independence Party candidate, Linda Guest, will introduce some much-needed nastiness to West Dorset. But no. Your correspondent finds her at a garage pouring water into the steaming engine of her improbable pink Fiat. Although her intervention could dish Mr Letwin, she has nothing at all against him. She also seems to be very nice.

The Tories should be able to dislodge Mr Knight, who secured Labour's only gain in 2001, but is an assiduous constituency MP and a formidable campaigner. On a canvassing swing with him through a sheltered-housing estate in Weymouth, an impressive number of its elderly inhabitants appear to know and like him. Tellingly, rather than discuss national politics, Mr Knight asks people whether he has done enough for them in the past four years to have earned their vote again.

His personal appeal seems to be working. Even a woman who has lost her job at the local Department for Work and Pensions office says she will probably vote Labour. But, lurking outside a primary school as parents arrived to pick up their children, Mr Knight fails to persuade two smartly dressed mothers to allow their offspring to accept Labour balloons. “*Daily Mail* readers,” he sniffs.

Ed Matts, the Tory candidate, has done his bit for Mr Knight. Mr Matts came to prominence last week when he was caught out having doctored a photograph of himself and Ann Widdecombe, a former minister and celebrity battleaxe, to turn a protest in favour of a refugee family into one calling for “controlled immigration”. Mr Knight will no doubt be making sure that the incident remains fresh in voters' minds until polling day.

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Wind farms

Fell-fight

Apr 21st 2005
From The Economist print edition

Plans for a big new wind farm highlight a schism among environmentalists

RENEWABLE energy is supposed to be the environmentalists' darling, but proposals for a big new wind-power development at Whinash, in Cumbria, have divided globally-minded greenies from their locally-sensitive cousins. The first group think the new turbines are necessary to combat climate change. The second says that the windmills would destroy a valuable landscape and damage the Cumbrian economy.

In the green corner supporting the development stand Friends of the Earth and Greenpeace. In the other green corner are the Campaign to Protect Rural England, the Cumbria Tourist Board and the Wildlife Trust, whose president, David Bellamy, has threatened to chain himself to one of the giant windmills in protest, if they are built.

Both sides make their cases on environmental grounds. The Wildlife Trust points out that the turbines will be built atop an area of blanket bog, a rare habitat that is protected under Cumbria's Biodiversity Action Plan. The concrete foundations that the turbines stand on and the access roads necessary to build and maintain them will, it says, destroy large parts of a rare ecosystem.

Opposing greens are unmoved. They say that the area is environmentally damaged anyway, thanks to drainage and over-grazing, and that the new wind farms would have only a minor impact. In any case, says Tony Juniper of Friends of the Earth, “the biggest threat to rare habitats is climate change itself.”

Kyle Blue, chairman of the No Whinash Wind Farm Committee, agrees that climate change is a worry, but is not sure about windmills. “The more I look at it,” he says, “the more the evidence seems to point to nuclear power as the answer.”

Greenery aside, the Cumbrian Tourist Board dislikes the economics of the plan: it frets that the giant turbines will drive away tourists. Again, Mr Juniper disagrees: “when I'm out walking, I quite like looking at wind turbines,” he muses.

Similar arguments have erupted around the country. The need for a strong, steady breeze means that many of the best sites for wind farms are just the sort of wild and windswept uplands that rural campaigners want to preserve.

Doug Parr, chief scientist at Greenpeace, says that one solution might be to build the turbines out at sea and out of sight. But Chalmerston Wind Power, the company behind the Whinash development, reckons that the government would have to provide extra subsidies before it would consider building offshore. Meanwhile, both sides are waiting to see which flavour of greenery goes down best with the public inquiry into the project (whose conclusions the government may well ignore—as is so often the way with these things).

Bagehot

Issues of identity

Apr 21st 2005
From The Economist print edition

The Tories' campaign is in difficulties because the party is divided about what it stands for

Get article background

THE recent crop of opinion polls, some suggesting that Labour has increased its lead over the Tories to ten points, may not accurately reflect the electorate's grumpy indifference, but one thing seems fairly certain. Unless something changes in the next fortnight, the slickest and most professional campaign the Tories have run for several elections will have done little to lift the party beyond its base support of around 32%.

What's going wrong? Partly it is the lack of a more appealing leader than Michael Howard, who, it should be remembered, finished last when Conservative MPs were electing a leader in 1997 (his selection in 2003, after two successive disasters, was uncontested). Partly it is because although voters have fallen out of love with Tony Blair, they are not yet desperate for change.

But something else, too, is holding the Tories back. Last week, Mr Blair came close to putting his finger on it. He said that the Tories reminded him of his own party in the late 1980s. Labour had recovered its desire for unity and discipline, but had not yet decided on a direction. It still didn't know what it was: the old-style socialist party it used to be or the modern social democratic party, comfortable with the market economy, that it was to become. His point was that until the Tories make up their minds whether to accept Labour's vision of a reformed but generously funded welfare system or to reject it by offering an alternative based on a smaller state, their central message will be both confused and confusing.

There's a lot in that. The Tories currently say that they will both cut taxes and either increase or maintain spending on health, education, defence and policing. While the sums can superficially be made to work, it doesn't stack up as a defining vision. Some people in Mr Howard's party complain that he has been absurdly timid in offering only £4 billion ($7.6 billion) of tax relief, while others fear that by talking about tax cuts he has obscured potentially good ideas about spreading choice and diversity in public services.

One can see why Mr Howard has settled for ambiguity. The Tories' own polling tells them there is little support either for reduced spending on key public services or for radical approaches to funding them. At the same time, most Tory activists, and probably MPs, yearn to take Margaret Thatcher's revolution to its next stage. The crime of Howard Flight, the Tory MP for Arundel who Mr Howard sacked at the start of the campaign, was to say that if they won, the Tories would be able to cut taxes and spending by more than they were letting on. Mr Flight was tacitly admitting that because New Labour had accepted so much of the Thatcherite settlement, her disciples' plans to extend it might well alienate small “c” conservative voters.

Faced with an electorate that thinks the argument about the size of the state is over, Mr Howard has steered away from conventional left-right issues to do with tax-and-spend and towards issues

to do with culture and identity. In this, he has been influenced both by his campaign manager, Lynton Crosby, who mobilised majorities for John Howard in Australia by putting immigration and crime at the centre of his election campaigns, and by the success of the Republicans in America in exploiting their country's “culture wars”.

The Tories know perfectly well that there is no equivalent in Britain of the American religious right. Religion, for most of the few who formally practise it in Britain, is a private matter. There is a small anti-abortion movement that was momentarily invigorated when Mr Howard signalled his support for lowering the legal time limit on abortions, but politicians from all sides quickly agreed it should not become an election issue. There is almost no public concern about gay marriage or stem-cell research and the prevailing attitude towards sexuality is liberal and tolerant. Mr Howard's own small “kitchen cabinet” includes two openly gay men.

Drawbridge up or down?

In their struggle to appeal to the socially conservative voter, that leaves the Tories with immigration, crime, gypsies, political correctness, bossy human-rights legislation and the erosion of national sovereignty by Brussels. Their enthusiasm for these issues has been criticised as pointless pandering to the party's core supporters. That's not quite fair. The Tories believe that these issues play just as strongly with Labour's working-class base. Stephan Shakespeare of YouGov, a polling firm, says the company's research suggests that, on a conventional left/right axis, most people cluster near the centre. By contrast, “drawbridge issues” divide the population: some people want to pull the drawbridge up to protect themselves from external threats while some want to keep it down, to welcome the big, beautiful world outside.

Unfortunately for the Tories, there are problems for them with this approach too. First, just as Mr Blair has made tax-and-spend issues difficult for the Tories, so his refusal to allow them a monopoly on pulling up the drawbridge pushes Mr Howard to go further than is either wise or attractive. Second, while the Republicans managed to sound culturally upbeat as well as socially conservative, the Tories have fallen into the trap of sounding sour about and disapproving of their country. Third, and perhaps most important, the party is nearly as divided on these issues as it is on the size and reach of the state. It cannot, for instance, make up its mind whether or not Britons should carry identity cards; and many of the party's MPs (especially its brighter, younger ones) are said to be uncomfortable about the direction in which Mr Howard is taking them.

Mr Howard has chosen to avoid confronting the Conservative Party about its identity problems. But until the Tories decide what they want to be, the voters are unlikely to decide that they should be a government.

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Vacancy: Britain section

Apr 21st 2005
From The Economist print edition

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Economist.com BUSINESS

The future of journalism

Yesterday's papers

Apr 21st 2005 | LONDON, NEW YORK AND SAN FRANCISCO
From The Economist print edition

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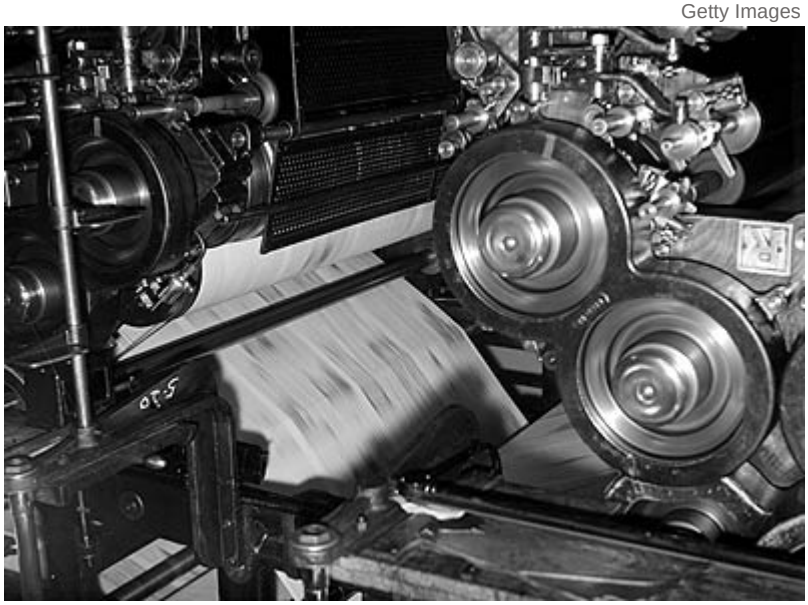

Is Rupert Murdoch right to predict the end of newspapers as we now know them?

“I BELIEVE too many of us editors and reporters are out of touch with our readers,” Rupert Murdoch, the boss of News Corporation, one of the world's largest media companies, told the American Society of Newspaper Editors last week. No wonder that people, and in particular the young, are ditching their newspapers. Today's teens, twenty- and thirty-somethings “don't want to rely on a god-like figure from above to tell them what's important,” Mr Murdoch said, “and they certainly don't want news presented as gospel.” And yet, he went on, “as an industry, many of us have been remarkably, unaccountably, complacent.”

The speech—astonishing not so much for what it said as for who said it—may go down in history as the day that the stodgy newspaper business officially woke up to the new realities of the internet age. Talking at times more like a pony-tailed, new-age technophile than a septuagenarian old-media god-like figure, Mr Murdoch said that news “providers” such as his own organisation had better get web-savvy, stop lecturing their audiences, “become places for conversation” and “destinations” where “bloggers” and “podcasters” congregate to “engage our reporters and editors in more extended discussions.” He also criticised editors and reporters who often “think their readers are stupid”.

Mr Murdoch's argument begins with the fact that newspapers worldwide have been—and seem destined to keep on—losing readers, and with them advertising revenue. In 1995-2003, says the World Association of Newspapers, circulation fell by 5% in America, 3% in Europe and 2% in Japan. In the 1960s, four out of five Americans read a paper every day; today only half do so. Philip Meyer, author of “The Vanishing Newspaper: Saving Journalism in the Information

Age” (University of Missouri Press), says that if the trend continues, the last newspaper reader will recycle his final paper copy in April 2040.

Gotcha!

The decline of newspapers predates the internet. But the second—broadband—generation of the internet is not only accelerating it but is also changing the business in a way that the previous rivals to newspapers—radio and TV—never did. Older people, whom Mr Murdoch calls “digital immigrants”, may not have noticed, but young “digital natives” increasingly get their news from web portals such as Yahoo! or Google, and from newer web media such as blogs. Short for “web logs”, these are online journal entries of thoughts and web links that anybody can post. Whereas 56% of Americans haven't heard of blogs, and only 3% read them daily, among the young they are standard fare, with 44% of online Americans aged 18-29 reading them often, according to a poll by CNN/*USA Today*/Gallup.

Blogs, moreover, are but one item on a growing list of new media tools that the internet makes available. Wikis are collaborative web pages that allow readers to edit and contribute. This, to digital immigrants, may sound like a recipe for anarchic chaos, until they visit, for instance, wikipedia.org, an online encyclopaedia that is growing dramatically richer by the day through exactly this spontaneous (and surprisingly orderly) collaboration among strangers. Photoblogs are becoming common; videoblogs are just starting. Podcasting (a conjunction of iPod, Apple's iconic audio player, and broadcasting) lets both professionals and amateurs produce audio files that people can download and listen to.

It is tempting, but wrong, for the traditional mainstream media (which includes *The Economist*) to belittle this sort of thing. It is true, for instance, that the vast majority of blogs are not worth reading and, in fact, are not read (although the same is true of much in traditional newspapers). On the other hand, bloggers play an increasingly prominent part in the wider media drama—witness their role in America's presidential election last year. The most popular bloggers now get as much traffic individually as the opinion pages of most newspapers. Many bloggers are windbags, but some are world experts in their field. Matthew Hindman, a political scientist at Arizona State University, found that the top bloggers are more likely than top newspaper columnists to have gone to a top university, and far more likely to have an advanced degree, such as a doctorate.

Another dangerous cliché is to consider bloggers intrinsically parasitic on (and thus, ultimately, no threat to) the traditional news business. True, many thrive on debunking, contradicting or analysing stories that originate in the old media. In this sense, the blogosphere is, so far, mostly an expanded op-ed medium. But there is nothing to suggest that bloggers cannot also do original reporting. Glenn Reynolds, whose political blog, Instapundit.com, counts 250,000 readers on a good day, often includes eyewitness accounts from people in Afghanistan or Shanghai, whom he considers “correspondents” in the original sense of the word.

“The basic notion is that if people have the tools to create their own content, they will do that, and that this will result in an emerging global conversation,” says Dan Gillmor, founder of Grassroots Media in San Francisco, and the author of “We the Media” (O'Reilly, 2004), a book about, well, grassroots journalism. Take, for instance, OhmyNews in South Korea. Its “main concept is that every citizen can be a reporter,” says Oh Yeon Ho, the boss and founder. Five years old, OhmyNews already has 2m readers and over 33,000 “citizen reporters”, all of them volunteers who contribute stories that are edited and fact-checked by some 50 permanent staff.

With so many new kinds of journalists joining the old kinds, it is also likely that new business models will arise to challenge existing ones. Some bloggers are allowing Google to place

advertising links next to their postings, and thus get paid every time a reader of their blog clicks on them. Other bloggers, just like existing providers of specialist content, may ask for subscriptions to all, or part, of their content. Tip-jar systems, where readers click to make small payments to their favourite writers, are catching on. In one case last year, an OhmyNews article attacking an unpopular court verdict reaped $30,000 in tips from readers, though most of the site's revenues come from advertising.

The tone in these new media is radically different. For today's digital natives, says Mr Gillmor, it is anathema to be lectured at. Instead, they expect to be informed as part of an online dialogue. They are at once less likely to write a traditional letter to the editor, and more likely to post a response on the web—and then to carry on the discussion. A letters page pre-selected by an editor makes no sense to them; spotting the best responses using the spontaneous voting systems of the internet does.

Even if established media groups—such as Mr Murdoch's—start to respond better to these changes, can they profit from them? Mr Murdoch says that some media firms, at least, will be able to navigate the transition as advertising revenue switches from print-based to electronic media. Indeed, this is one area where news providers can use technology to their advantage, by providing more targeted audiences for advertisers, both by interest group and location. He also thinks that video clips, which his firm can conveniently provide, will be crucial ingredients of online news.

But it remains uncertain what mix of advertising revenue, tips and subscriptions will fund the news providers of the future, and how large a role today's providers will have. What is clear is that the control of news—what constitutes it, how to prioritise it and what is fact—is shifting subtly from being the sole purview of the news provider to the audience itself. Newspapers, Mr Murdoch implies, must learn to understand their role as providers of news independent of the old medium of distribution, the paper.

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Ford and General Motors

How much worse can it get?

Apr 21st 2005
From The Economist print edition

Detroit's finest are in dire straits

Get article background

THIS week General Motors (GM) reported a loss of $1.1 billion for the three months to the end of March, its worst quarterly performance since 1992, when the carmaker teetered on the brink of bankruptcy. More worrying still, it refused to make a forecast for the whole of this year and gave no outline of any plans to tackle its problems. Ford's figures for the same period, announced a day later, at least showed a profit, but this dropped by 38% from the same period last year, to $1.2 billion. On top of this depressing result, Ford shocked the markets by abandoning its goal, set in 2002, of a $7 billion annual profit by the end of next year. The Chrysler division of DaimlerChrysler is doing better, having moved upmarket and gained sales with successful new models—but next week it is expected to forecast a 10% fall in profits this year.

For the past two years the threat of collapse has hung in the Detroit air as America's car firms have wrestled with falling sales, unprecedented competition at home and soaring retirement and health-care costs for current and former employees. No one really expects either GM or Ford to seek Chapter 11 bankruptcy protection this year or next, but the likelihood is growing fast that they will do so eventually.

GM's cash outflow from its car business was $3 billion in the first quarter, 50% more than it had forecast for the whole year. Between its car business and its profitable finance arm, the GM group has some $26 billion in cash. But how long will that keep it solvent if cars continue to bleed money? People in Detroit should remember that MG Rover, the rump of Britain's domestically-owned car industry which went bust earlier this month, was the world's third-biggest car company in the 1970s.

And the more that Detroit's finest retrench, the greater the burden of their “legacy” retirement and health-care costs will become proportionately: GM now has 2.5 pensioners for every current employee. In 1999, a deal between Detroit's big three carmakers and the United Auto Workers Union (UAW) included generous healthcare benefits for pensioners as well as workers. These are locked into labour deals that run until 2007.

This largesse has come to haunt Detroit. The late 1990s were highly profitable, thanks to booming sales of sport-utility vehicles and other light truck-based vehicles which generated profits of around $10,000 per unit. But since then, Asian and European rivals have raised output from their North American factories to compete in this niche, Detroit's last redoubt. So, in a stable market of 16.5m-17m vehicles a year, GM's share has fallen from one-third to barely one-quarter and Ford's from one-quarter to less than one-fifth.

Neither GM nor Ford has ignored these problems. GM now employs only 324,000 people, compared with 877,000 20 years ago. It has laid off workers, closed factories and outsourced parts supplies.

Likewise, Ford has closed five American factories in the past three years, cut production for the past 11 quarters and will go further still to lower stocks of unsold cars. Even so, it started this month with 81 days of stock (GM had 79), about one-third above normal levels for Detroit and well above the levels for Nissan, Honda and Toyota (the latter, a super-lean 36 days). But lower production in North America means that fixed legacy costs have to be spread more thickly across shrunken revenues. In GM's case, they have gone from 2.3% of revenues in 1999 to 5% this year, according to a study by CreditSights, an independent research firm. Absent this burden, the operating-profit record of GM is reasonable (see chart).

But this burden is not going to go away magically. There is no prospect of the federal government riding to the rescue of Detroit by taking over its legacy costs. GM hopes that the unions will co-operate to limit health-care costs. It has assigned one of its top four managers, Gary Cowger, to explore the possibility of a deal soon.

Some observers think that GM is quite happy with the growing talk of going into Chapter 11, because it may scare the UAW into making concessions, rather as America's airlines have wrung wage cuts from frightened employees (if not always soon enough to stop them going bust). Although the current union deal lasts for another two years, the UAW may well give some ground on health-care benefits before then. But the trouble with talking up the possibility of bankruptcy—or not complaining much when others do—is that it can frighten the bond markets even more than the unions. GM's bonds are already trading at junk prices, even though the ratings agencies persist, oddly, in regarding them as investment-grade. As a result of the drop in its bonds, the firm faces higher financing costs, adding to its woes.

To be sure, GM has cut losses in Europe, has turned round Latin America and enjoys healthy profits even in a faltering Chinese market (see article). In the long-term, it could have a glittering future—for it leads the world in pollution-free hydrogen fuel-cell cars. But can it last that long?

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Economist.com BUSINESS

China's car market

Shanghaied

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From The Economist print edition

Things are going awry for foreign carmakers in China

STRUGGLING elsewhere, the world's carmakers are increasingly relying on China, with its 1.3 billion potential customers, to bail them out. Comforting forecasts abound. McKinsey, a consultancy, expects China, already the world's fourth-largest car market with sales of 2.3m in 2004, to overtake Germany this year and Japan by 2010. America, with 17m cars sold a year, could be passed soon after.

That will be the official message at the Shanghai motor show, which opened to the public on April 22nd. Yet, in truth, China's car market is ailing. After soaring by more than 55% in 2002 and over 75% in 2003, growth in car sales slowed abruptly last year, to 12%. In the first quarter of 2005, sales actually fell by nearly 8%, though there was a small rise in March.

The main culprit has been the Chinese government's crackdown—to help cool its still booming economy—on the car loans that fuelled much of the spectacular recent sales growth. This is colliding with a big rise in capacity, the result of optimistic earlier growth forecasts. In the past two years, almost every foreign carmaker has declared an ambition to increase mainland production. Despite recently giving warning of margin pressures from price wars, General Motors (GM) insisted that it will stick to its $3 billion plan to double capacity to 1.3m units by 2007. In total, foreign car firms and their local joint-venture partners plan to invest $15 billion to triple output to over 7m cars by 2008. Such growth and consequent over-supply is common in emerging markets—often leading to bust, as it did in Brazil in 1997-98. In China, capacity problems are exacerbated by expanding domestic car firms.

The glut threatens to slash prices already hit by slowing demand and China's commitment to the World Trade Organisation to cut its high tariffs on imported cars. The price of a Volkswagen (VW) Jetta, a popular mid-market model, has already fallen by one-third in the past three years, to 100,000 yuan ($12,000) in late 2004.

This is hitting profitability. In 2003, VW earned over $500m in China, two-thirds of its total global profits. Last year its Chinese profits more than halved; Goldman Sachs forecasts that it will lose over $500m in China this year. Its market share—50% not so long ago—has plunged to barely 10%.

Management change is suddenly rife. On April 17th, VW said that Winfried Vahland, vice-chairman of its Skoda unit, will replace Folker Weissgerber, a former board member responsible for China, and Bernd Leissner, head of China, who is to retire. Weeks earlier, GM announced the departure of its China boss, Phil Murtaugh.

The new bosses face a growing threat from Chinese carmakers. Traditionally, the domestic industry has been weak, fragmented—China has over 120 (mostly small) car firms—and technologically primitive. Some 90% of cars sold in China are foreign brands. But China's government has long aspired to create global car champions. One big firm, Shanghai Automotive

(SAIC), which has joint-ventures with both VW and GM and plans a $1 billion overseas listing of its shares this year, is busily buying foreign car technology—most recently from Britain's failed MG-Rover. Firms unconstrained by foreign partnerships are even more aggressive. Chery (part-owned by SAIC) and Geely are both accused of blatantly copying foreign car technology. GM says that Chery's popular small QQ model is a direct rip-off of its Chevrolet Spark. Both GM and Toyota have failed to win court protection in China for their intellectual property.

Chinese firms are cornering the crucial market for the small, cheap cars that now appeal to middle-class buyers no longer able to borrow heavily to pay for a bigger vehicle. Two of the three top-selling models in March were Chinese brands—Chery's QQ and FAW's catchily named TJ7101U. They are under-cutting the foreign firms by using more cheap labour relative to capital. Shanghai GM's car plant is full of robots. At Geely's factory, 40 minutes south of Shanghai, visitors are jolted back to the past, watching workers sweat to bolt car bodies together by hand.

“We must make cars like people from Wenzhou make lighters”, says Li Shufu, Geely's boss, revealing the extent of his ambition: Wenzhou city makes one-quarter of the world's lighters. Though there are technical and quality hurdles to overcome, Chinese car firms plan big capacity growth, and want to sell cars overseas. Chery, which already sells 8,000 cars a year abroad, plans to enter America in 2007 and has its eye on Europe. On April 15th, Brilliance (BMW's partner in China) revealed plans to build its *Zhonghua* (“Chinese nation”) sedans in Egypt this year. Added to the other bad news for foreign car firms, that prospect may take some air out of the tyres in Shanghai this week.

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Economist.com BUSINESS

The drinks industry

Santé

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Does it make sense for Pernod Ricard to buy Allied Domecq?

WHEN he took over at Pernod Ricard from his father Paul in 1978, Patrick Ricard became boss of a French family firm born of the merger of two producers of pastis, an aniseed-flavoured *aperitif* popular in southern France. In two decades he has made Pernod a global firm, the owner of Chivas Regal whisky, Martell cognac and other spirits. Now he has done his biggest deal: on April 20th, Pernod announced the $14 billion purchase of Britain's Allied Domecq. The combined firm will be a rival to Diageo, also British and until now the uncontested market leader.

The takeover will double Pernod's size by most measures. It will boost its presence in America, the biggest market for quality spirits, and Latin America. It will bring Pernod famous brands: Beefeater gin, Stolichnaya vodka, Ballantine's whisky and the Malibu rum-and-coconut drink. And, say analysts, it will cut costs by €240m ($300m)—3-4% of net annual sales.

Before pursuing Allied, Mr Ricard first had to digest his takeover of one-third of Seagram's drinks business in 2001. He then had to find a partner to share the bill. He agreed to cede some Allied products to Fortune Brands, an American firm, in return for a contribution of €3.5 billion. Pernod will raise about €8 billion in equity and debt. The rest will come from selling Dunkin' Donuts, Baskin Robbins ice cream and other non-drinks assets of Allied.

The partnership with Fortune may also help resolve antitrust problems. Charles Winston, an analyst at Merrill Lynch, foresees trouble for Pernod with America's Federal Trade Commission (FTC), because of its dominant position in Irish whisky. Will it be allowed to own both Beefeater and Seagram's gin? Fortune could take on such brands without regulatory problems, though it would probably not be allowed Allied's whisky. Pernod says Fortune will take on Allied's Courvoisier cognac, since it already owns Martell.

Mr Winston has doubts about the deal, though. With Seagram, Pernod and Diageo bought only assets, leaving Seagram's pension-fund liabilities and capital-gains tax (CGT) tax to its owner, Vivendi Universal. Pernod and Fortune will have to take on Allied's pension deficit, at least £387m ($740m), and pay CGT if assets are sold on.

A last-gasp rival offer for Allied is unlikely. Private-equity firms seem not to be lurking. Diageo is already too big in most markets. LVMH, a French luxury-goods conglomerate, has said it is not interested. Bacardi or Brown-Forman (owner of Jack Daniels whiskey) or Constellation Brands (another American drinks group), would each find it hard to raise the money. As they do not now have global networks, economies of scale from using Allied's distribution system would be lower.

If all goes to plan, Mr Ricard will retire in 2008. His three children show no great interest in the booze business. A nephew, now working at Pernod, could be a successor. But Mr Ricard is likelier to pass the baton to a close confidant outside the family; the final touch in the transformation of a smallish pastis maker into the world's second-biggest spirits group.

Gold mining

The Russians are coming

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South Africans had better take note of Norilsk Nickel's ideas for gold

VLADIMIR POTANIN and Mikhail Prokhorov, joint bosses of Russia's Norilsk Nickel, want to be global gold tycoons as well. In 2002 Norilsk bought Polyus, Russia's largest gold producer; in 2003 two smaller gold miners there; and last April 20% of Gold Fields of South Africa, one of the global giants. This week Norilsk, whose shares are quoted in Moscow and on NASDAQ, announced plans to hive off all its gold interests into a separate company, also quoted at home and abroad.

And next? Last October, Norilsk pledged its support to a takeover bid for Gold Fields launched by a smaller South African rival, Harmony. But money-losing Harmony could offer only paper, not cash, and its shares soon slumped (by this week to 46% below their pre-bid price). The bid won little other support. It is still limping through regulatory hurdles, but shows few signs of life, and fewer still of success. Norilsk began wavering long ago.

Gold Fields this week was saying it would love to work with Norilsk as a “partner” and, by implication, in Russia. Norilsk may well have grander ideas. Its gold output, around 1m ounces a year, is only one-quarter of Gold Fields's; and the Gold Fields share price this week, after the Norilsk news, offered no hint of any future merger scheme, let alone bid, from Russia. But rule nothing out: Mr Potanin, a dollar billionaire, and Mr Prokhorov, Norilsk's chief executive, are not short of ambition.

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Economist.com BUSINESS

Expatriate workers

In search of stealth

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Today's global businesses have created a new kind of expat

CARLOS GHOSN is a Brazilian who, from next month, will be spending 40% of his time in Paris as the new boss of Renault, 35% in Tokyo where he will continue as the head of Nissan, and 25% elsewhere, most of it in America. Jean-Pierre Garnier is a Frenchman who heads a British drugs company (GlaxoSmithKline) but spends up to 70% of his working life outside Britain and France. Who is first in line for the tax on these executives' not inconsiderable incomes? And, er, have they got the necessary work permits?

These two bosses are the most visible examples of a growing army of mobile workers who are giving human resources (HR) departments a new sort of headache: how to track where they are and when, for tax and visa purposes. Brian Friedman, president of Ernst & Young's Institute for Global Mobility, says this is a major challenge for such departments. Gone are the days when working abroad was merely a matter of signing a formal expatriate package—with an allowance for differences in the cost of living and the quality of life—before waving goodbye for three years.

Today's global business is creating a new sort of worker, termed the “stealth expatriate” in a recent worldwide survey by Cendant Mobility, a firm that helps firms to relocate employees. The survey found that 78% of HR departments either have, or suspect they have, stealth expats within their firm. Yet 83% of these companies admit that they do not have systems in place to track such people.

Stealth expats come in two main varieties: one is the cross-border commuter, a growing phenomenon particularly in the European Union (EU), where the relaxation of border controls and spread of low-cost airlines have made weekly commuting between cities such as Brussels, London and Paris almost commonplace. The other is the accidental expat—someone who goes on so many business trips or temporary assignments that he inadvertently incurs new fiscal liabilities or overstays his welcome as a foreign worker.

The traditional expat, the man with “FILTH” stamped on his personnel file (Failed in London; Try Hong Kong), is probably declining, says Jill Storey of KPMG. Companies dislike them because they cost up to 50% more than their counterparts back home. And expats today find it ever harder to persuade spouses, who may also have a career, to follow them into the remoter parts of the corporate jungle.

Stealth expats, though, are increasing for several reasons. The popularity of offshoring and cross-border joint-ventures requires more executives to go on short-to-medium-term assignments abroad—a flow that goes in all sorts of directions. A large number of software engineers who live in India spend big chunks of time on assignments in Britain and America, where there is high demand for their skills.

Multinationals are organised more along business lines these days than on geographic lines. Country managers are increasingly likely to have been hired locally—many firms insist that expats

revert to local employment conditions if they stay in one place for more than five years—while business units are run by globe-trotting teams, the members of which may live in a number of different countries.

The tax rules applicable to stealth expats can be fiendishly complex. Income-tax liability across the EU still kicks in at very different stages. A self-employed British-born consultant who lives near Toulouse, but works mostly in Brussels and London, is taxed by Britain's tax authorities. As long he does not have a French client, *le fisc* will leave him alone.

Anyone who spends more than 90 days in Britain in any one fiscal year (between the arcane dates of April 6th one year and April 5th the next) can become liable to British income tax. This used to be something watched carefully by airline pilots. Increasingly, though, their passengers too need to check that they are not being accidentally trapped in fiscal snares.

To avoid such traps, HR departments are starting to track employees' foreign movements more systematically. Some are linking up with the firm's travel agent, when there is one; others may use mobile-phone bills as an audit trail. Mr Friedman says that global mobility will continue to rise, as will the pay of those who take on the demanding job of a stealth expat. Governments will need some stealth of their own if they are to catch up with the reality of these taxpayers' working lives.

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Japanese takeovers

Livedoor cuts a deal

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A depressing end to a fascinating battle

AP

Horie gets cosy with the suits

WHEN his war with Fuji TV began less than three months ago, Takafumi Horie talked of all the new and exciting things that he and his internet firm, Livedoor, would do for Japan's stale media industry. But Fuji TV's business group mounted a ferocious defence against Mr Horie's attempt to take over its radio affiliate, Nippon Broadcasting System (NBS)—including trying to dilute his stake, until Mr Horie blocked that in court. Yet the harder Fuji TV fought, the more Mr Horie's insurgency broadened into a high-profile assault on corporate Japan's hidebound ways. On April 18th, however, Mr Horie stood hand-in-hand with his former rivals and announced a new business alliance between Livedoor and Fuji TV. Apart from the 32-year-old Mr Horie's T-shirt and youthful appearance, the scene looked just like all of the other corporate compromises that Japan so routinely churns out.

The deal will allow for some progress. In January, after long ignoring complaints from shareholders, Fuji TV unveiled a plan to streamline its two-way shareholding arrangement with NBS by paying up to ¥171 billion ($1.6 billion) for control of NBS, which also has a 22.5% stake in Fuji TV. Livedoor's bid for NBS—it bought half of NBS's shares—had put this plan on hold.

Fuji TV will now buy all of Livedoor's NBS shares at a slight premium. It will also work with Livedoor to promote links between its traditional broadcast media and the upstart internet company. To cement the relationship, Fuji TV will make an all-too-typical equity investment in Livedoor, paying ¥44 billion for a 13% stake.

As well as failing to win outright control of NBS, and cutting a deal with Fuji TV's management, Mr Horie has sent the value of Livedoor's shares down over 25% since early February, and his financing methods have diluted the stakes of existing shareholders. He no longer looks the champion of shareholder-friendly business methods he claimed to be.

The big winners have been investors who bought early stakes in NBS and then urged Fuji TV to do something sensible with its warped financial structure. The most prominent of these was M&A Consulting, headed by Yoshiaki Murakami, which runs an activist fund that urges badly managed firms to disgorge their excess cash to shareholders. Mr Murakami's fund enjoyed a huge run up in NBS's share price after Fuji TV caved in to initial demands for change, and then as Mr Horie bid up NBS's shares further.

As for corporate Japan in general, the results of the Livedoor battle have been equally disappointing. Managers at many other firms have been scared by the spectacle and are now scrambling to adopt new shareholder rules that will make it easier to thwart takeover bids in future. A slew of firms are set to adopt such “poison pills” at annual general meetings in June.

Given the lousy returns on capital of most Japanese firms, the case for letting outside bidders take a shot at running many of them is strong. But entrenched managers are well placed to resist, so change is likely to be gradual, at best. The excitement that Livedoor generated a month ago seems dead as a doornail.

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Face value

Prophet of American technodoom

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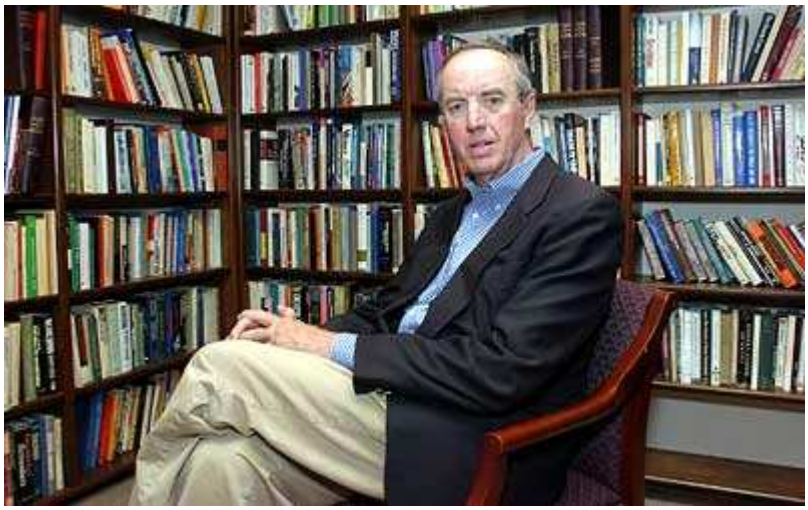
AP



Thomas Bleha reckons that America is falling disastrously behind in broadband

AMERICA may have been the birthplace of the internet, but it has now fallen behind its Asian rivals in the race to upgrade to high-speed broadband connections, with potentially devastating economic consequences. That is the bold claim made by Thomas Bleha, a former United States Foreign Service officer, in a much-discussed article in the latest issue of *Foreign Affairs*. In 2001-04, Mr Bleha notes, America fell from fourth to 13th place in global rankings of broadband internet usage. While George Bush focused on tax cuts and the war on terror, America's internet leadership was stolen by Japan and South Korea, where governments vigorously promoted the roll-out of very high-speed broadband connections—up to 40 megabits per second, compared with 1.5mbps or less in America. And America is even further behind in wireless broadband services on mobile phones. “These countries' progress will have serious economic implications,” Mr Bleha writes. “Japan and its neighbours have positioned themselves to be the first states to reap the benefits of the broadband era: economic growth, increased productivity, technological innovation and an improved quality of life.”

The role of cyberpundit is new to Mr Bleha, who turns 70 in June. After retiring in 1986, he worked at universities until 2002, when he began a fellowship to research the internet in Japan, where he had worked in the 1960s and 1970s. The notion of international broadband rivalry will be central to his forthcoming book on the race for internet leadership. His article has struck a chord at a time when Americans are fretting about competitiveness again. Yet are things really as bad as Mr Bleha says?

While America has indeed slipped down the global broadband rankings, in which South Korea is the undisputed leader, it has mostly been overtaken by small, densely populated countries such as Denmark, Belgium and Iceland, which are more easily wired up than America's open plains and

sprawling suburbs. With 11 broadband subscribers per 100 people, America is (unlike, say, Britain and Germany) above the rich-country average of nine and not all that far behind Japan (13), says the OECD. In other league tables, such as the United Nations rankings for information-technology diffusion, America remains in pole position, with South Korea 14th and Japan 17th.

It is not just the number of broadband subscribers that worries Mr Bleha, but also the speed of access and its cost. Yet although it is true that very high-speed connections are more widely available in Japan's cities than in America's, they are starting to appear in America too, where telecoms operators are building new fibre networks to carry TV and other advanced services. SBC, for instance, plans to spend $4 billion to cover 18m homes by 2007. Verizon and BellSouth have also committed to boosting broadband speeds and building fast new fibre networks; Qwest said last week it was extending its new fibre networks, too. Part of the delay was due to regulatory concerns: telecoms firms did not want to invest in costly network upgrades only to be compelled to share their new networks with rivals at inexpensive rates. America's telecoms regulator has signalled that this will not happen, so deployment has accelerated.

In wireless, too, America's situation is less bleak than Mr Bleha fears. It is true that Japan and South Korea are the clear leaders in third-generation (3G) wireless-broadband services, with tens of millions of subscribers. But similar 3G networks are now being rolled out in America by Verizon Wireless, closely followed by Sprint. And Cingular, another American operator, is rushing to build its own 3G network, using a new technology called HSDPA. Indeed, Cingular has now overtaken Japan's leading wireless operator, NTT DoCoMo, in the race to deploy HSDPA. Until recently, other countries sniggered at America's backwardness in wireless, but such criticisms now seem dated.

Mr Bleha argues, however, that broadband drives economic growth, so the lag in deployment will damage America's global competitiveness. Yet the two studies he cites (one sponsored by Verizon), which suggest that the American economy potentially stands to lose up to $500 billion a year, may exaggerate the situation. One author admits that any figure is mainly guesswork. Moreover, few applications currently require super-fast broadband: faster links make online games smoother and the sharing of big video files easier, but for most users—and, indeed, America's economy—ordinary broadband is good enough for now.

Don't panic

Mr Bleha wants ambitious targets to be set by the President's Information Technology Advisory Committee, a group representing industry and academia. The problem with America's current policy on broadband, he says, is that the country has no policy, uniquely among industrialised nations.

But that is not quite true. The industry regulator, the Federal Communications Commission (FCC), has tried to make it costly for rivals to piggyback on the infrastructure of today's telecoms and cable firms in order to create an incentive for them to compete using alternative infrastructures, such as powerlines or wireless. “This is more competitive, more sustainable, and easier to administer,” says Michael Powell, who quit as FCC chairman in March. “That means in the long race we're behind the pack for a while, but we're trying to create three or four platforms.”

Ultimately, Mr Bleha is a classic American techno-alarmist. In the 1980s, Cassandras worried about America's car industry; in the 1990s, the concern shifted to electronics. Sometimes, as with cars, the alarm is justified; in other cases the threat is overstated. In this case, Mr Bleha is criticising American policy before it has had time to produce results. Still, Mr Bleha is emerging as the technology industry's unlikely Luther, posing the right questions at a sensitive time. “I've stated my case,” he says. “We'll have to see whether it is overstated or not.”

Economist.com BUSINESS

India's IT and outsourcing industries

The Bangalore paradox

Apr 21st 2005 | BANGALORE
From The Economist print edition

Reuters

The city at the heart of India's booming information-technology industry is already choking on its own success; but the boom has barely begun

THE arriving businessman, anxious to get to grips with India's information-technology industry in its very capital, may need a little patience. He might meet his first traffic jam just outside Bangalore's airport. He can examine the skeleton of the early stages of a planned flyover on the airport road. Construction started in February 2003 and was due to be completed in April 2004. Three-quarters of the work is still to be done, but the building site is idle. A dispute over cost escalation led to a cancellation of the contract (the rusting steel that forms the skeleton was getting more expensive by the day).

To say the least, this is bad public relations for Bangalore, the hub of the great Indian boom in software and remote services, such as call-centres (known as “business process outsourcing”, or BPO). It seems to confirm recent scare stories that the city has ground to a halt, and its government does not care. Late last year, some of the leading lights of Indian information technology (IT), such as Wipro's founder, Azim Premji, and his counterpart at Infosys, Narayana Murthy, gave warning that Bangalore was in trouble. The *Indian Express*, a national newspaper, took up the cause with a front-page series on “Bangalore crumbling”.

Elections last May in the state of Karnataka, of which Bangalore is the capital, were taken as a rebuff for the urban elite from the poor rural majority. After a series of failed monsoons, farmers were suffering. Driven into the grip of usurious money-lenders, more than 700 had killed themselves in the year before the elections. So the new administration, under its chief minister, Dharam Singh, a portly grass-roots politician who prides himself on his common touch, forswore

the “urban bias” of its predecessor.

The city soon felt the pain of the government's inattention. “As companies we have scaled up,” says Bob Hoekstra, boss of a big Bangalore software centre for Philips, a Dutch consumer-electronics giant. “But the government has scaled down.” Bangalore's infrastructure was already creaking after years of breakneck expansion. Yet foreign firms were continuing to pour in at the rate of three a week. Newly prosperous residents have kept buying motorcycles and cars, adding, say officials, 900 vehicles a day to the already overloaded streets.

The government showed its disdain for the IT billionaires by allowing the withering of the “Bangalore Agenda Task Force”. This was an initiative led, and largely financed, by Nandan Nilekani, chief executive of Infosys, to improve governance and infrastructure in Bangalore through partnership with the private sector. Worse still, from the IT industry's point of view, the government decided to apply an “entry tax” of 13.5% on goods brought into the state—a big burden on firms relying on imported computers.

For those perennially pessimistic about India, all this was just the latest proof that its democratic structure will always end up stifling its economic prospects. Bangalore alone accounts for about one-third of India's software exports and, with 265,000 workers, nearly one-third of total employment in IT services and BPO. No other Indian city has such an “ecosystem” of mutually reinforcing strengths. So one would expect Bangalore's woes to have a nationwide impact.

Yet Wipro and Infosys are taking on nearly 1,000 new staff every month. There were jitters this month on the stockmarket after Infosys forecast a sluggish quarter ahead. But NASSCOM, the industry's lobby, expects Indian IT services to continue to grow by 25-28% annually. BPO, from a much smaller base, will grow even faster, by 35-40%. The three biggest Indian IT firms—Tata Consultancy Services, Infosys and Wipro—are now among the top ten globally in terms of stockmarket capitalisation, gross profits and employees.

There are a number of explanations for this paradox. First, Bangalore's troubles, while serious, are not terminal. Second, India has plenty of other locations for IT and BPO investment. But third, and most important, these are still businesses with fantastic potential, and India's advantages are so great that, however bad its aim, it will be hard-pressed to shoot itself in the foot.

Bangalore, say officials, is the fastest-growing city in India. Its population, only 800,000 in 1951, had grown to 5.6m in 2001, and is estimated at 7m now. It appealed to the British Raj's soldiers—and then to Indian pensioners—because of its beautiful, mild climate, the finest in India, and the lush greenery of its many parks and gardens.

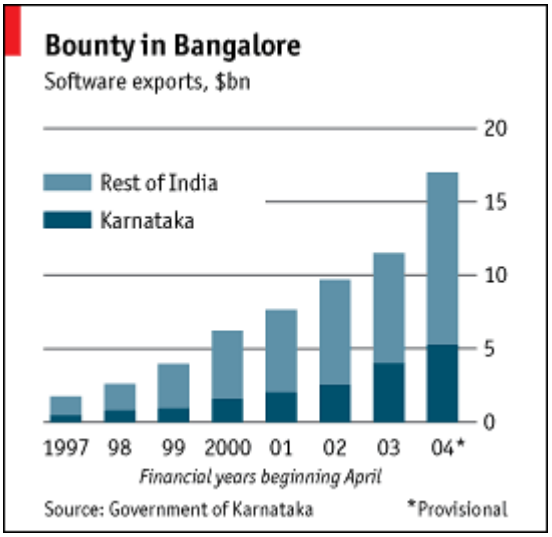
The home of science

That still helps draw the IT industry, as do its technical and scientific institutes. It is home to the Indian Institute of Science, singled out in the Indian budget this year as a centre of excellence in research and development to be promoted as a “world-class university”, as well as the location of the organisation spearheading India's space programme. Karnataka has 77 engineering colleges producing more than 29,000 graduates a year.

Now, to these attractions are added an abundance of talent, a relaxed and cosmopolitan atmosphere, and a lively nightlife. Many recent graduates come, at their parents' expense, to hunt for a job. The big IT firms have built huge campuses in Electronics City, a few kilometres out of town. Some are as modern and efficient as anything in Silicon Valley, from the state-of-the-art remote network-management systems to the cappuccino bars.

But commuting is a nightmare. Bangalore suffers the infrastructure shortcomings common to many Indian cities: a water shortage, inadequate sewers, an erratic power supply, and pot-holed roads too narrow for the traffic they need to bear. But Bangalore may be unique in the speed of its decline. Samuel Paul of the Public Affairs Centre, an outfit that monitors the government's performance, says it shows that just a few months of neglect are enough to undo years of improvement. Hearing the negative signals about Bangalore that the new government sent out, many city workers stopped bothering. The result: “total urban chaos”, according to Sudip Banerjee, boss of Wipro's “enterprise solutions” division.

But this chaos has not infiltrated the Wipro campus, however, nor those of its competitors. They build much of their own infrastructure. Their virtual connections to the West sometimes seem stronger than their physical ties to India. “Our body is in India,” says Mr Nilekani, “but our head is in New York or somewhere.” So the impact of “crumbling” is diluted. In the long run, it may make Bangalore a less attractive destination. But firms still have to coax Bangalore-based staff with incentives to move elsewhere.



The grouses tend to focus on the traffic, the airport and the shortage of hotel rooms. On all three counts, say Mr Singh's officials, help is at hand. His government has approved—and budgeted for—an impressive list of new roads, including a second outer ring road, and a 9-km (5-mile) elevated toll-road to Electronics City, to be built in partnership with the firms based there. A metro rail system is also planned, although only once the central government has given its approval.

That should not, these days, be an obstacle. The long-planned new airport was held up when the party in power in Delhi was in opposition in Bangalore. Now that both state and federal governments are coalitions led by the Congress party, ground is at long last due to be broken next month. This is in partnership with the foreign and Indian private sector, the first time this has happened in India.

Similarly, officials say 2,000 new hotel rooms are under construction, with another 2,000 on the drawing board. For now, five-star hotel rooms are mostly unavailable. One hotel manager recently was heard boasting he had met his 2005 revenue targets at the end of February, thanks to 100% occupancy and a $400 a night rate for rooms that two years ago cost only one-quarter as much.

Few in the IT industry have much good to say about the new government. At least, however, it is pretending to be friendly to business. It has dropped the entry tax for exporting firms and is even talking of setting up a committee with the private sector, along the lines of Mr Nilekani's defunct

task-force. All its talk of expansion will inevitably be bogged down in bureaucratic delay, and the building will itself cause disruption. Things will get worse before they get better. But are they now, or will they become, very much worse than elsewhere in India? Probably not.

Bangalore's troubles will, however, encourage local and foreign firms to examine the many other options available. It used to be, says Partha Iyengar of Gartner, a consultancy, echoing an old IBM advert, that in the IT industry, “no one ever got fired for choosing Bangalore”. Now the city is a “drastic victim of its own success” that is becoming less and less attractive. For the most sophisticated work, in research and development, Philips's Mr Hoekstra argues there is still no alternative: “if Bangalore sinks, India sinks”. But he wishes the Karnataka government had deterred the call-centres. For them, and many other BPO activities, there is plenty of choice.

Gartner has classified Indian cities in four “tiers” of attractiveness to foreign firms seeking to outsource work to India. Bangalore, along with Delhi and Mumbai, occupies the top tier. But it lists six places as “Tier 1-1” cities, just behind the leaders. They are Gurgaon and Noida, the fast-growing towns on the edges of Delhi; Mumbai's new town; Chennai (formerly Madras) and Hyderabad in the South and Pune in the West. Then there is a whole range of places just below that vying for business. Last month Dell, an American computer giant, opened a contact centre in Mohali in the north. Kolkata (once Calcutta) is trying to shed its image as a bastion of labour militancy and is aggressively courting investment in IT and BPO.

IT spreads its wings

Most of the big Indian IT firms and many of the smaller ones have operations in several Indian cities. Vee Technologies, a BPO firm with its headquarters in Bangalore, employs 300 people there for its “high-cost work”, but about 500 in the town of Salem, about three hours away, where costs are lower and staff far easier to retain. Lakshmi Narayanan of Cognizant, an American IT firm with its main Indian base in Chennai, says IT job-hunters are starting to move there and to Hyderabad to look for work, as they do to Bangalore. Chennai alone has an estimated 100,000 software professionals, and is expected to add another 50,000 this year.

Mr Narayanan says companies such as his worry more about mounting costs than they do about the infrastructure. Bangalore, with the influx of foreign firms pushing up wages, is where they are mounting fastest. P.V. Kannan, boss of 24/7 Customer, a BPO firm, reckons the city is about 10% more expensive than other places in India. Staff attrition—running as high as 40% for the industry as a whole, and even higher at the lower end of the call-centre market—is a particular problem because of all the foreign firms.

But even fast-rising costs—especially in retaining staff—are not a serious constraint on growth. Joseph Sigelman, of OfficeTiger, a Chennai-based BPO firm, says that staffing probably accounts for only about one-third of overall costs, and 15% annual wage inflation has to be set against falling costs in other areas—especially telecommunications.

The successful firms are expanding aggressively. OfficeTiger expects to double the number of its employees to about 4,000 by the end of the year. 24/7 Customer added 1,200 people in the past year, and has 4,200 now. It expects to grow by 40% this year and next.

Reasons to be cheerful

Optimism about India's prospects in these businesses is based, firstly, on the sheer range of work now encompassed by the IT and BPO industries and, second, on its potential for further

expansion. The business that started it all—offshore software development—still has plenty of room to grow. The world becomes more dependent on IT by the day. Even as new applications are churned out, old ones need maintaining and even newer ones developing.

The youthful BPO business, meanwhile, is still defining itself. At one end, say at 24/7 Customer, it involves telephone marketing to hapless British householders unaware they need a new credit card; or fielding a call from a nice lady in a bank in Exeter in western England, who wants to send a credit card by courier to Antigua, and is presumably unaware that the efficient, London-accented courier executive she deals with is sitting in Bangalore.

Such call-centres are the best-known and biggest part of BPO. At the other end of the spectrum, even high-end research-and-development work is being outsourced. The Bangalore offices of HCL Technologies, for example, is designing a back-up navigation system for Airbus.

In between, the range of business processes that can be outsourced is constantly expanding: processing insurance claims; desktop publishing; the remote management and maintenance of IT networks; compiling audits; completing tax returns; transcribing medical records; financial research and analysis. The list of possible activities is almost endless. “We have barely scratched the surface,” says Stefan Spohr of A.T. Kearney, a consultancy.

Mr Spohr says that in financial services it will in a few years be nothing unusual for big multinationals to have 20-25% of their staff in India. Already many big banks have moved large parts of their back offices here. Most have done so through “captive” operations, offering large one-off savings. The trend is likely to be towards outsourcing to “third-party” BPO firms. Deutsche Bank, for example, uses HCL Technologies in Bangalore, with which it used to have a joint-venture, to process many “live” trading transactions as well as perform some research and analysis. Similarly, General Electric last year sold 60% of its back-office services arm, GE Capital International Services, an India-based outsourcing giant and pioneer.

External constraints seem less likely than they did a year ago to stem the growth of outsourcing. As a political issue, the alleged job losses it brings have less prominence in America and Britain than they did last year. That may change, in the event of a sharp downturn in the global economy. But a more immediate risk is an increasing concern about data security. One or two minor lapses aside, the Indian BPO industry had until recently been remarkably immune from scandal. But in early April, a fraud was uncovered at the Pune office of the outsourcing arm of MphasiS, a big IT-services firm. Present and former MphasiS employees had used information acquired at work to hack into American bank accounts and steal some $350,000.

Forrester, a research outfit, forecast that the incident, combined with the high rates of staff attrition in Indian call-centres, would dent call-centre expansion by as much as 30%. That seems too gloomy. Such crimes can happen anywhere. India's record is still a good one, and the thieves in Pune were detected and caught. Security at the best Indian call-centres is tight. Computers have no disk drives; hardly any data are downloaded; mobile phones and cameras are banned.

Ironically, MphasiS's boss, Jerry Rao, chairs NASSCOM's security forum, and has campaigned for standards to be raised higher than those prevailing in Britain and America, in order to make data protection a selling-point for India. Protectionist scares aside, the commercial logic behind the outsourcing trend is such that it seems more likely to accelerate than hit a speed-bump. India remains well placed to win a big share of the business. Its biggest regional competitors are China and, for English-language voice work, the Philippines. Both compete with India on price, but neither can match its annual supply of more than 2m English-speaking graduates.

Higher degrees

The qualities of those graduates give India its biggest competitive advantage and, in the long run, the one that gives most cause for concern. Partha Iyengar of Gartner forecasts that in 5-7 years' time, many of the software processes at present performed manually in offices in Bangalore will be automated. India will have to move upmarket and “who is going to convert the army of programmers into businessmen?”

The biggest constraint on the growth of India's service industries may be the available talent pool. Nevertheless, the bullish projections for Indian IT and “IT-enabled services” produced in 2002 by NASSCOM and McKinsey seem within reach. They forecast that the combined industries would, by 2008, employ 4m people (up from fewer than 900,000 in 2004), earn $57 billion-65 billion from exports (compared with $17 billion in 2004), and account for 7% of GDP (compared with 4%).

The challenge this poses for the firms leading the boom is how to expand fast enough to meet demand without jeopardising quality. For quality, as much as cost, is what is driving the demand. It is in this context that Bangalore's troubles have to be seen: as the acute growing pains of a still-infant industry. It is a worry not because the difficulties are insuperable, but because some can be solved only by the government. India's IT industry has thrived in part because, unlike most other sectors of the economy, it has largely kept the government out of its business. That period is coming to an end. Neglect, the industry is learning, is not always benign.

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American shares

Looking for trouble

Apr 21st 2005
From The Economist print edition

FLPA

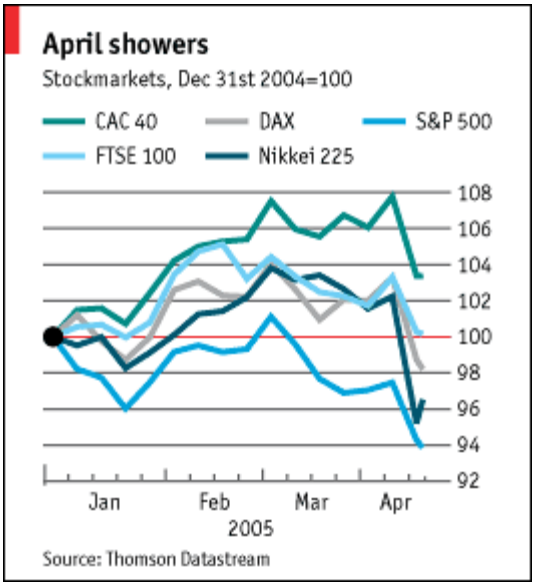
The American stockmarket has taken a tumble. Why are investors so jittery?

LIKE a mob of meerkats alert to any approaching danger, investors in American shares take fright easily these days. Spooked by mixed economic and company news last week, they fled stocks for bonds, pushing down the big share-price indices to their lowest in five months and dragging markets in Europe and Japan with them (see chart below). Spirits revived a bit this week, despite the first-quarter loss of $1.1 billion announced by General Motors on April 19th. But the little creatures turned tail again the next day, when unexpectedly high inflation and low fuel supplies sent share and bond prices down and oil prices up. Are investors right to be so nervous?

It is true that the domestic economic news is beginning to point to an unhappy combination of lower growth and higher inflation. Four big sets of statistics for March—employment, retail sales, manufacturing production and housing starts—suggest that the American economy is losing momentum. This week's inflation data were surprisingly bad: consumer prices rose by 0.6% in March alone; the core index (which excludes volatile food and fuel prices) rose by 0.4%. Core inflation in the first three months of the year was 3.3% at an annualised rate, well above the Federal Reserve's comfort zone. Some now think that the Fed may speed up its recent step-by-step increases in interest rates.

This adds to the stockmarket's fear that the American consumer, on whose shoulders the world's economic

growth now rests, is buckling as interest rates and oil prices rise. A weaker housing market could complete the consumer's undoing: prices have climbed by 65% across the nation since 1997 and by much more in some areas, and the boom has helped to fuel an increase in household debt and consumption. A reported drop of almost four points to 88.7 in the University of Michigan's April consumer-sentiment index added to this week's chill. Amid talk of “stagflation”, the S&P 500 share index headed down again, closing on April 20th at 1,137.5, 4.2% lower than on April 12th, when the most recent slide began, and 6.1% lower than at the start of the year.

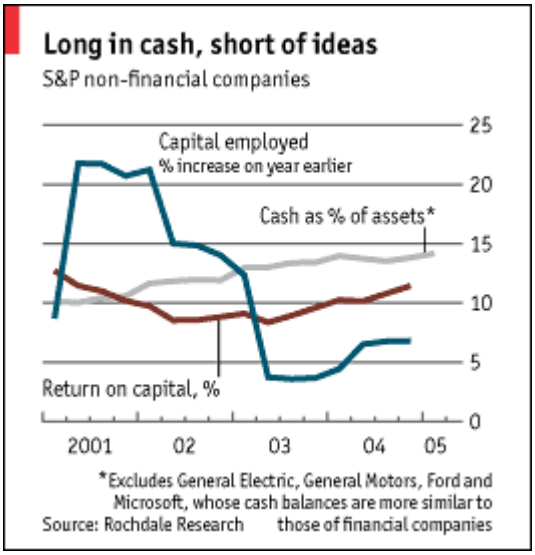


Against this background, first-quarter corporate earnings have not been especially solid. There are plenty of stars—Apple, Yahoo!, Intel, Caterpillar, General Electric, Bank of America, Wachovia—but plenty of weak spots too—not least IBM, whose disappointing earnings gave investors the jitters last week, Coca-Cola and virtually anything that moves (General Motors, Ford, Continental Airlines). Though lower than last year's, forecasts of growth in corporate profits in 2005 have increased since the year began, according to Thomson First Call, a research firm that tabulates brokers' estimates. In that, however, they seem not to reflect investors' sentiments.

Three well-known measures of investor confidence now indicate a sharp reversal of mood. In March, of the 324 global fund managers (with more than $1 trillion in assets among them) that Merrill Lynch surveys each month, 11% more believed that economic growth would increase than that it would decrease. In April, their views were the opposite: 20% more thought that growth would fall than that it would rise. The survey found a similar shift in beliefs about an increase in corporate profits, and the fund managers' assumption of higher inflation continued. An index compiled by State Street Global Markets shows that investors are reallocating assets away from the riskier ones, in expectation of hard times to come.

Jumping at shadows

All this nervousness might look a little odd. After all, corporate America has emerged from the dark days of 2000-02 with increased productivity, strengthened balance sheets and mostly huge profits. The economic news is not catastrophic, merely intermittently depressing. So why this rumbling unease that reveals itself whenever a fact or figure disconcerts?



One possible answer comes from Rochdale Research, part of a boutique broker-dealer in New York. Nicholas Colas, head of research there, suggests that firms have achieved their strong balance sheets and impressive cash balances (at non-financial firms in the S&P 500, equal to 14% of total assets at the end of 2004) by underinvesting in their operations, despite the good global growth of recent years. They have tended to their financial ratios and paid out huge dollops of cash to shareholders through dividends, special repayments (Microsoft) and share repurchases (Citigroup, Merrill Lynch, Dell,

and many others in the S&P 500). What they have not done is place bold bets on their own future growth, despite a recent uptick in mergers and acquisitions in which private-equity firms make much of the running. Since companies have done little to generate growth internally, they are unusually dependent on macroeconomic trends for it.

This makes sense. As the chart above shows, American firms are taking in more cash than they know what to do with. The return on non-financial S&P firms' capital employed has been rising, reflecting healthy profitability; the rate of growth of capital employed, having dropped sharply in 2002-03, has picked up only slightly, reflecting the reluctance to invest.

In part, this is a function of size. The bigger a company gets, the harder it is to manage what it has, still less to come up with something new. Citigroup is in divesting mode (it announced the sale of its Travelers life-insurance business to MetLife in January), at least for the moment. Microsoft, though energetic, has not found a way to compensate for what seems to be the natural diminution of its business through the growth of open-source software and computing alternatives to the PC.

In part it is also a function of a shift in corporate power in America to stronger, mainly institutional, shareholders from chief executives weakened by a climate of muddle and outright scandal. There is no harm in a company returning to shareholders cash for which it has no profitable use: that is what responsible stewardship would dictate. But it is also possible that powerful shareholders' own short-termism influences the decision: it is harder to estimate the eventual long-run profits from business expansion than it is to see the immediate gap between the return on shares (3.3% total trailing annual return for the S&P 500 as a whole) and the lower reward available on the cash it takes to buy them back.

And what of other stockmarkets, wrestling—especially in continental Europe and Japan—with their own economic demons as well as with America's? Markets in Britain, France and Germany all fell this week, though the British and French indices are still higher than at the start of the year. On April 20th, Japan's Nikkei rose, heartened by Intel's strong performance, before falling again on America's renewed gloom. It is all in the eye of the beholder.

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Economist.com FINANCE & ECONOMICS

Stock exchanges

If you can't beat 'em, join 'em

Apr 21st 2005 | NEW YORK
From The Economist print edition

A transformative deal for the New York Stock Exchange

IF JOHN THAIN, the chief executive of the New York Stock Exchange (NYSE), learned anything in his many years at Goldman Sachs, it was: if in doubt, cut a deal. The one he unveiled on April 20th—the purchase of the all-electronic Archipelago exchange—may transform his 212-year-old, floor-based, not-for-profit mutual company into the world's most modern financial market.

The deal, which is subject to approval by shareholders and regulators, would give the NYSE's 1,366 seat-holders (and owners) 70% of the new company and $400m in cash. Archipelago shareholders would get the other 30%.

This continues the wave of consolidation that has seen the number of electronic exchanges dwindle from a dozen in the 1990s to about five. More matches may follow: NASDAQ and Instinet are expected to announce their union. Because trades gravitate to the most active exchanges which offer the most liquidity, peripheral markets, notably regional exchanges, have withered away.

This changed a bit over the past decade as the NYSE began to lose some market share to new, faster, cheaper all-electronic rivals exemplified by Archipelago. Meanwhile, its reputation was tarnished by successful prosecutions of Big Board traders who put their own interests ahead of their customers', and by weaknesses in its self-regulatory function. Seat prices slid—although they have risen strongly in recent weeks.

Now Mr Thain has made strides on all fronts. The NYSE is to spin off its regulatory arm into a separate, not-for-profit entity, removing potential conflicts of interest. And it will become a listed, for-profit company without following the lengthy route, via de-mutualisation and a public offering, that has taken other exchanges years. The merger also gives the exchange a way into NASDAQ-listed stocks, in which Archipelago has a 25% market share, and the growth business of derivatives trading.

Many hurdles still lie ahead. For now at least, the Archipelago merger only brings the two firms under the same roof; it does not knit them together. There are no plans yet to integrate the two exchanges' technical platforms or businesses, calling into question the synergies behind the deal. So NYSE and Archipelago shareholders will continue to have competing interests. In particular, NYSE owners, many of whom are traders with an interest in the continued existence of a trading floor, are likely to resist moves towards an all-electronic format, and may even stymie the deal. “The merger won't go down quietly,” says Benn Steil, a financial expert at the Council of Foreign Relations. In becoming a for-profit company, the NYSE also will have to manage a difficult change in its relationship with other Wall Street firms, which were part of the mutual structure but are now competitors as well as customers.

The ultimate test of the merger's success will be whether it lowers the cost of trading. Richard Grasso, Mr Thain's predecessor, who was booted out after a scandal over the size of his pay

packet, did not manage this in his long tenure. If Mr Thain can meld the two businesses and pull this off, the deal will be a brilliant coup. If he fails, the NYSE will continue to have a struggle on its hands.

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Economist.com FINANCE & ECONOMICS

Consumer lending in China

Safe as houses?

Apr 21st 2005 | SHANGHAI
From The Economist print edition

Another big problem looms for China's rickety banks

CHINA'S banks have been scrubbing hard, hoping to make themselves clean enough to attract foreign capital. If you believe official figures, their non-performing loan (NPL) ratio fell to 13.2% at the end of last year, from nearly 18% in 2003. None has scrubbed harder than the two big state banks being groomed for strategic investment and flotation: Bank of China (BoC) said last month that its NPL ratio was just 4.7%, and China Construction Bank (CCB) claims 3.7%. Independent data are also looking less gloomy. Standard & Poor's, a credit-rating agency, reckons 35% of loans will go sour, down from its previous estimate of 50%. This may help win round foreign banks, which have so far resisted taking stakes. Royal Bank of Scotland is said to be ready to pay up to $4 billion for up to a fifth of BoC, although the Edinburgh bank would not be drawn at its annual meeting on April 20th. There are also rumours that foreigners are preparing to buy a stake in CCB.

The banks' old bad debts are worrying enough. But potential investors should probably be more concerned about what has yet to appear in the books. Between the start of 2001 and early 2004, China went on an almighty credit binge. Bank lending jumped by 56% in 2003 alone, as the government first tried to shore up growth and then lost control of a racing economy before trying to rein it in last spring. At the state's behest, banks lent enormous sums for new factories, roads and airports, many of which will never make money.

However, for the first time they also lent hand-over-fist to individuals, deluging them with credit cards, mortgages and car loans in an attempt to make growth more balanced by encouraging consumer spending. A tenth of all outstanding bank loans, or around 2 trillion yuan ($242 billion), is now owed by consumers. Mortgages, which account for 90% of this, grew at an annual compound rate of 115% between 1998 and 2004, according to KGI, a securities firm. Last year, they rose by 38%, against just 6% for corporate loans (see chart). Banks have been delighted to grant home loans because they carry only a 50% weighting in the calculation of risk-weighted assets—a tribute to the perceived safety of mortgages.

That may be a dangerous misperception. Last June, the National Audit Office warned of

widespread consumer-credit problems, citing one borrower who was lent enough in multiple mortgages to buy 128 apartments. China lacks a national consumer-credit database to spot overstretched debtors, although a pilot system linking seven cities was set up late last year. Never having seen a complete mortgage-credit cycle, Chinese banks appear not to understand the downside risks. And they have few channels to lay off risk: the central government has repeatedly stalled moves to securitise consumer loans.

For now, the economy is accelerating: it grew by an unexpectedly fast 9.5% in the first quarter, according to figures published this week. That means default rates are low: 2-3% for mortgages, says KGI's Chuan Tang. But it may also herald a harder official crackdown on a frothy housing market. Last month the authorities introduced a capital-gains tax on property in Shanghai and forced banks to raise mortgage rates. Interest rates are likely to go up again, leading to an increase in bad debts. KGI estimates that a rise of just one percentage point in mortgage NPLs would knock 11.4% off the earnings of Shanghai Pudong Development Bank, 9% off China Minsheng Bank and 7% off China Merchants Bank. And these listed banks are in better shape than their bigger unlisted cousins.

The car-loan business shows what can happen when the state applies the brakes. Thousands who borrowed to buy cars in the past three years simply stopped paying after the government tightened credit. Without proper records, it has been impossible to trace defaulters, even if they gave correct information in the first place. Volkswagen, the leading carmaker in China, puts the default rate on loans in Beijing at 5%, ten times that in Europe. Other reports suggest that 95 billion yuan of banks' car loans, or 50%, are overdue. More than 30 billion yuan is owed to Agricultural Bank of China, the weakest of the four big state lenders. Most foreign firms investing in China see the Chinese consumer as the answer to their prayers. The world's banks might want to think otherwise.

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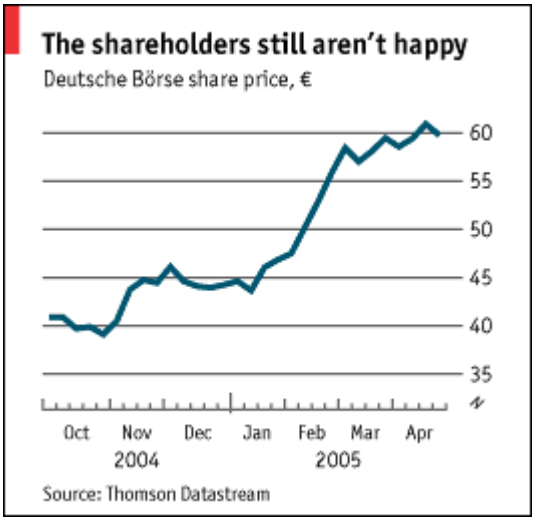
Economist.com FINANCE & ECONOMICS

Deutsche Börse

Clash of capitalisms

Apr 21st 2005 | FRANKFURT
From The Economist print edition

A battle between shareholders and management rumbles on



SINCE December, when Deutsche Börse declared its intention to buy the London Stock Exchange (LSE), a row has raged between the German exchange company's bosses and a London hedge fund that owns 8% of its shares. This investor, The Children's Investment Fund (TCI) succeeded in getting Deutsche Börse to shelve its bid on March 6th, but the battle over the company's governance goes on.

This week the two sides exchanged another round of testy letters. Christopher Hohn, managing partner of TCI, is not satisfied at merely thwarting the bid for the LSE. He wants Rolf Breuer, head of Deutsche Börse's supervisory board, voted out at the annual general meeting (AGM) on May 25th. Mr Hohn's critics in Germany, who extend far beyond the company's top brass, argue that his aim is a quick profit, not the long-term good of Deutsche Börse. Mr Hohn, pointing to the rise in the share price since he took up the cudgels, from €43.50 to around €60 (see chart), says that the previous discount reflected poor corporate governance.

Last week Mr Hohn filed AGM proposals to oust Mr Breuer and to vote no confidence in the entire supervisory board. A majority of votes represented at the meeting is required to carry each motion. This week Mr Hohn also called for the head of Werner Seifert, Deutsche Börse's chief executive: “Mr Breuer and Mr Seifert have been running the company as if it was theirs. That is rather absurd: we are owners, Mr Seifert is an employee.”

The company retorts that Mr Hohn represents a minority. Maybe: that will be seen at the AGM. Whatever happens, Mr Hohn has shown up real weaknesses in governance. It seems clear that Mr Breuer and Mr Seifert did not consult the full supervisory board on their bid strategy. Nor did they spend enough time canvassing major shareholders, perhaps because German law requires the approval only of the supervisory board, not shareholders, for a takeover bid.

Since Mr Hohn's strident intervention, Deutsche Börse has been keener to placate shareholders. It plans to buy back shares and to set up a “shareholder committee” which will be consulted before supervisory-board meetings. However, the company says it might yet have another crack at the LSE. The shareholder committee will have no power, says Mr Hohn. A supervisory board meeting on April 20th found little merit in Mr Hohn's proposals—to no one's surprise—but agreed to form a committee to discuss things with TCI.

The root of the problem is that an old-boy network still supervises lots of German companies, including Deutsche Börse. Mr Breuer is also chairman of the supervisory board of Deutsche Bank,

no longer a major shareholder in the exchange, but most recently its financial adviser and financier for the LSE bid. “The conflict of interest is clear and not optimal,” says Jürgen Kurz of DSW, a shareholder interest group. The supervisory board includes at least three other members with connections to Deutsche Bank: one used to be finance director of DaimlerChrysler, in which the bank has a 10% stake; another ran its asset-management subsidiary; the third runs a transaction-processing business whose main client is Deutsche Bank.

There is a clear case for reform, but German politicians too often defend the established way of doing business. This week Hans Eichel, Germany's finance minister, fretted about the growing role of short-term thinking rather than long-term corporate strategy. He referred specifically to Deutsche Börse and “what some of its shareholders are doing”. Mr Eichel has an eye on an election in North Rhine-Westphalia, Germany's most populous state, on May 22nd. His Social Democratic Party is in trouble there, and a dig at Anglo-Saxon capitalism could win votes.

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Economist.com FINANCE & ECONOMICS

Ireland's property developers

The Celtic reconquest

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Irish property groups are bursting out of their island across Europe

HE WAS once a Dublin tax inspector. These days Derek Quinlan runs a multinational property group. Financed by private investors, Quinlan Private last year beat off rivals to buy four of London's grandest hotels. This week it seized another slice of London's grandest commercial property. And its excursions abroad are not confined to Britain. Nor is it alone: Irish financiers are buying into Britain and mainland Europe.

Mr Quinlan's group, born in 1989, first won wide notice last year, when it paid £750m ($1.4 billion) to Blackstone and Colony Capital, two big American investors, for the Savoy Group, owners of London's Savoy, Claridge's, Berkeley and Connaught hotels; not the world's largest hotel group, with only 772 bedrooms, but in Britain hotels don't come swankier than that.

Not that Britain was Quinlan's first big step abroad. Earlier, it had bought the Four Seasons hotels in Budapest, Prague and Milan, besides commercial property in the Czech Republic and Hungary. It owns office blocks and shopping centres in mainland Europe and North America. This January it sold on the Savoy hotel, reportedly for a £30m profit on the 2004 valuation of £200m-odd, and now it is into another big London buy: a 3.4-acre (1.4-hectare) site owned by the BP pension fund, close to Harrods department store.

For the 40 shops, 150,000 square feet (14,000 square metres) of offices, a couple of hotels and some flats, Quinlan will pay some £520m. That looks plenty: the yield will be only 4.25% or so, if one takes into account the vendor's £22m two-year rental guarantee, reported by CB Richard Ellis (CBRE), the agent handling the deal, and a sliver under 4% if not. Even now, after solid price rises, yields in this part of London are around 4.25% for top shops, 5% for prime offices, and few expect them to drop further. The Irish are being bold.

But then bold they are. CBRE reckons they put around £2.3 billion into British property last year—and that excludes hotels—and may spend about as much in 2005. Already this year a group headed by Sean Quinn, a hugely rich Fermanagh entrepreneur, has bought the famous Belfry golf course and hotel for £186m; and three big Irish deals totalling £360m have been completed in London alone.

One, some £170m for a building in the City, the financial district, came from Sloane Capital, a group backed notably by John Magnier and J.P. McManus, two Irish tycoons best known for their Coolmore racehorse stud and chunk of Manchester United football club. A few months earlier Sloane had spent as much to buy Unilever's London headquarters. It went on to buy a big store building in Manchester, and, this month, the one that houses the flagship Ralph Lauren store in Manhattan.

The Irish have been buying widely. On CBRE figures, they put the equivalent of £600m into mainland Europe last year, £265m of it into ex-communist countries now in the European Union. Mr Quinn's group owns two hotels in Prague. Another group, Markland, has bought offices and

shops there, including, last month, the city's best-known department store (and a complex legal wrangle with it).

Markland is part-owned by Ballymore, a group set up in 1982 to serve Irish do-it-yourself home-builders, that now has assets in Britain, Hungary and Slovakia. It has already built hundreds of flats in London, is building a 29-storey tower of them, and has ambitions higher still. In the former docklands, a 36-storey tower linked to a 50-storey one already has planning permission and—given mayoral approval on top, and finance—will be completed in 2009, says Ballymore. It will be the tallest residential building in Europe.

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Economist.com BUSINESS

Economics focus

A choosier approach to aid

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Is America's Millennium Challenge Account too challenging for its own good?

THE island republic of Madagascar, off the east coast of Africa, boasts exotic flora, endangered fauna and a rare distinction: it is the only country so far to get any money out of America's much-heralded Millennium Challenge Corporation. The corporation is itself an unusual species. It is an institution that promises to give money, out of a fund called the Millennium Challenge Account (MCA), only to honest governments pursuing sound economic policies that impress it with a proposal of their own devising. So far, it has been remarkably picky. Unveiled by George Bush in 2002, it made its first grant, of $110m, only on April 18th.

The more established aid agencies have not always been as cautious. For example, the World Bank and the African Development Bank are still owed about $40 billion by 30 or so poor countries that are chronically unable to repay. In the few days before Madagascar received its new money, the legacy of these old loans was still playing on the minds of the finance ministers of the G7 rich nations meeting in Washington, DC. Once again, they failed to settle on a plan to write off “as much as 100%” of the bad loans on the multilateral lenders' books.

In the past, America has also showered its official aid on countries that either did not greatly need it or did not much deserve it. The country's main aid body, the United States Agency for International Development, must often play second fiddle to the State Department, which is keen to see money flow to strategic allies—such as Israel, Egypt, Jordan and Pakistan—that are either poorly run, or not that poor.

The MCA offers a fresh approach to American giving. It takes its inspiration from a group of World Bank economists, principally Craig Burnside and David Dollar, who argued that aid only works in countries pursuing sound economic policies: their research concluded that if a poor country has high trade barriers, a misaligned exchange rate, unstable prices and weak public finances, it is infertile soil for aid. Although their results have been disputed, a slightly weaker version of their argument commands a broad consensus: aid may do some good even in basket cases, but it certainly works better in countries with honest governments and sound policies.

The MCA is based on no fewer than 16 different indicators of a country's honesty and soundness, including its credit rating, its treatment of civil liberties, its spending on health and education, and how long it takes to start a business. The indicators are necessarily crude—they cover 70 eligible countries, and some of the statistics are rough at best—but they are at least public, unlike the grounds for the backroom judgments made by other aid agencies. It is thus harder for lobbying and politics to bias selection, but not impossible. Steven Radelet, of the Centre for Global Development in Washington, reckons that Georgia made the list of 16 approved countries only because the Bush administration wanted to back its new government. A worthy aim, he says; but it should be financed by the State Department, not the MCA.

Implicitly, eligible countries are competing with each other for MCA funds. On all of the indicators

except inflation, the standards are relative, not absolute: countries are asked to do better than their peers. For example, a country cannot qualify for aid unless it ranks in the better half for corruption. The indicator of corruption is based on figures compiled by Daniel Kaufmann and Aart Kraay, of the World Bank. But they themselves worry that their gauge is simply too broad to make the necessary distinctions. In a ranking of 61 poor countries for which data were available in 2000-01, they could be 90% certain that Sudan and Burundi were correctly classified in the bottom half of the table. They could not be so sure of any of the other 28 countries that would fail to make the cut.

According to the World Bank's Global Monitoring Report, published earlier this month, the poor world is dividing into “aid orphans”, bereft of any patron, and “aid darlings”, doted on by competing agencies. The danger is that the MCA's all-or-nothing, in-or-out criteria might make this polarisation worse.

Discriminate and devolve

That said, a highly selective approach can have its advantages. A donor that is picky about which countries it helps need not be as fastidious about how its money is spent. America asks governments to pitch their own home-grown projects for MCA money, demanding only new ideas and measurable results. Britain's aid ministry, the Department for International Development, has taken this a step further. It is careful about which governments it supports, but quite laisser-faire about how its money is used. In some countries, as much as half of the aid it provides is not set aside for any specific scheme at all. It is instead provided to a ministry, such as health, or the general government budget. The functions of the state, after all, cannot always be parcelled into eye-catching $110m packages.

On April 26th, the Senate is due to begin hearings on the MCA. The initial goodwill the idea enjoyed is giving way to some scepticism. By the normal standards of aid money, cash has been awfully slow to flow out of the MCA. Some of this criticism is warranted. America was quite quick to pick the countries it wanted to help, but it has been very sluggish in approving their projects. But some of the disquiet misses the point. Giving aid in a systematically selective way does two things. It maximises the return to the aid that is given. But it also encourages governments to reform so as to qualify for aid in the future. This second effect might be most powerful in countries denied money.

The success of the MCA will not be measured by the number of dollars it hands out, but by the changes that it brings about in the countries it supports. Sometimes in the aid industry, withholding money can be as important as bestowing it.

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Marjorie Deane internship

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Applications are invited for the 2005 **Marjorie Deane internship**. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a young would-be or junior journalist, who will spend three months of the summer at *The Economist*, writing about finance. Applicants should send a letter introducing themselves, with an original article of about 1,000 words intended for the Finance and economics section. Applications must reach us by May 3rd. They should be posted to The Business Affairs Editor (Deane internship), The Economist, 25 St James's Street, London SW1A 1HG, or e-mailed to deaneintern@economist.com

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Economist.com SCIENCE & TECHNOLOGY

Environmental economics

Are you being served?

Apr 21st 2005 | PANAMA CITY
From The Economist print edition

Environmental entries are starting to appear on the balance sheet. Perhaps soon, the best things in life will not be free

Get article background

AT THE Miraflores lock on the Panama Canal it is possible to watch the heartbeat of international trade in action. One by one, giant ships piled high with multi-coloured containers creep through the lock's narrow confines and are disgorged neatly on the other side. If it were not for the canal, these ships would have to make a two-to-three-week detour around South America. That would have a significant effect on the price of goods around much of the world. It is therefore sobering to consider that each ship requires 200m litres of fresh water to operate the locks of the canal and that, over the years, this water has been drying up.

Scientists at the Smithsonian Tropical Research Institute, in Panama, think that reforesting the canal's denuded watershed would help regulate the supply. One of them, Robert Stallard, a hydrologist and biogeochemist who also works for the United States Geological Survey in Boulder, Colorado, has operated in the country for two decades, and knows the terrain well. A deforested, grass-covered watershed would release far more water in total than a forested one, he admits, but that water would arrive in useless surges rather than as a useful steady stream. A forested watershed makes a lot more sense.

Another problem caused by deforestation is that it allows more sediment and nutrients to flow into the canal. Sediment clogs the channel directly. Nutrients do so indirectly, by stimulating the growth of waterweeds. Both phenomena require regular, and expensive, dredging. More trees would ameliorate these difficulties, trapping sediments and nutrients as well as regulating the supply of fresh water. Planting forests around the Panama Canal would thus have the same effect as building vast reservoirs and filtration beds.

Viewed this way, any scheme to reforest the canal's watershed is, in fact, an investment in infrastructure. Normally, this would be provided by the owner. But in this case the owner is the Panamanian government, and Panama is in debt, has a poor credit rating and finds it expensive to borrow money. And yet investing in the canal's watershed clearly makes economic sense. Who will pay?

In the case of the Panama Canal, the answer may turn out to be John Forgach, an entrepreneur, banker and chairman of ForestRe, a forestry insurance company based in London. Mr Forgach's plan is to use the financial markets to arrange for companies dependent on the canal to pay for the reforestation. Working in collaboration with several as-yet-unnamed insurance and reinsurance companies, Mr Forgach is trying to put together a deal in which these companies would underwrite a 25-year bond that would pay for the forest to be replanted. The companies would then ask those of their big clients who use the canal to buy the bond. Firms such as Wal-Mart, and a number of Asian carmakers, which currently insure against the huge losses they would suffer if the canal were closed, would pay a reduced premium if they bought forest bonds.

This is meant to be a good business deal, but it is structured in a way that brings environmental and social benefits, too. The forest will have a diverse mixture of species that the Smithsonian's scientists have demonstrated grow well (thus pleasing environmentalists), are valuable, and which local people have deemed to be useful for food and medicine. It is also a test case for Mr Forgach. If he succeeds, he will try it elsewhere because he thinks there is an opportunity in treating the regulation of water and climate as a utility—in other words, as a service for which people will pay money. This, he says, should be a perfectly viable investment.

In from the cold

In the case of the canal, the financial value of reforestation is clear even if who pays for it is not. But putting a cash value on what are called variously “environmental”, “ecosystem” or “ecological” services has, historically, been a fraught process.

Early attempts at such valuation resulted in impressive but unsound figures that were seized on by environmental advocates and then, when they were discredited, used by opponents to tar the whole idea. Now, though, things have improved.

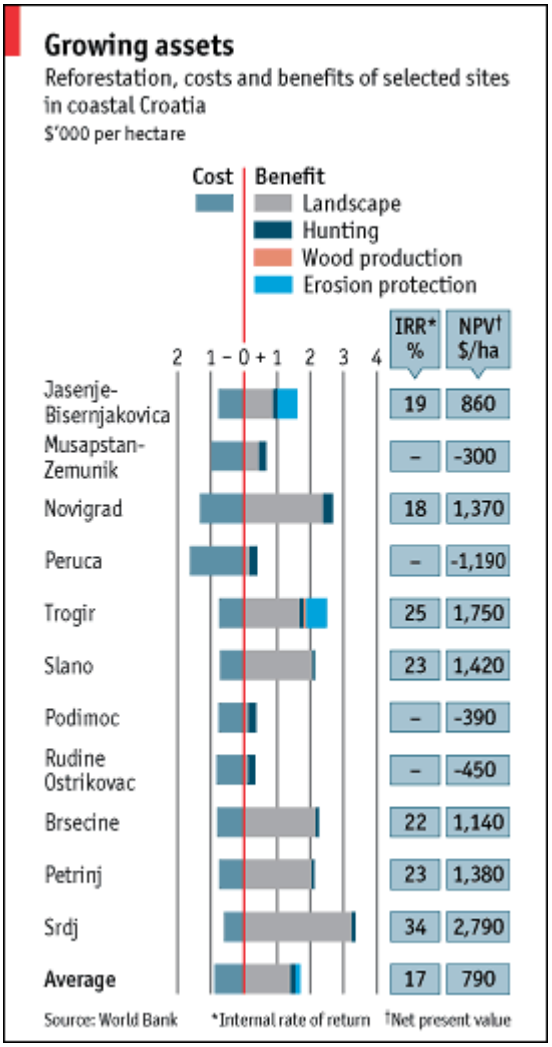
First of all, science is producing abundant evidence that the natural environment provides a wide range of economic benefits beyond the obvious ones of timber and fish. Ecologists now know a great deal more than they used to about how ecosystems work, which habitats deliver which services, and in what quantity those services are supplied. Last month, for example, saw the publication of the Millennium Ecosystem Assessment, the first global survey of ecological services. Its authors warn that attention will have to be paid to these services if global development goals are to be met.

But the only way this can happen is if ecological services have sound, real (and realistic) values attached to them. As “Valuing Ecosystem Services”, a report written recently for America's National Research Council, points out, the difficult part is providing a precise description of the links between the structures and functions of various bits of the environment, so that proper values can be calculated. What this means is that the more there is known about the ecology of, say, a forest, the better the valuation of the services it provides will be. Fortunately, according to two reports published by the World Bank at the end of 2004, significant progress has been made towards developing techniques for valuing environmental costs and benefits. There is, says one of these reports, no longer any excuse for considering them unquantifiable.

The turning point for this way of looking at things was in 1997. In that year, the city government

of New York realised that changing agricultural practices meant it would need to act to preserve the quality of the city's drinking water. One way to have done this would have been to install new water-filtration plants, but that would have cost $4 billion-6 billion up front, together with annual running costs of $250m. Instead, the government is paying to preserve the rural nature of the Catskill Mountains from which New York gets most of its water. It is spending $250m on buying land to prevent development, and paying farmers $100m a year to minimise water pollution.

Many of the valuation studies done since then have involved water, probably because it is so obviously a valuable ecological service. Forests and swamps (or “wetlands”, to give the latter their politically correct modern moniker) filter and purify water, and act as reservoirs to capture rain and melting snow. When such areas become degraded, it may be necessary to make expensive investments in treatment plants, dams and other flood-control measures. Several other American cities, following in New York's footsteps, have calculated that every dollar invested in environmental protection would save anywhere from $7.50 to $200 on the cost of what would otherwise have to be spent on filtration and water-treatment facilities.



Nor it is it only rich countries that benefit. In 2003, Muthurajawela wetland sanctuary, just north of Colombo in Sri Lanka, was calculated by the World Conservation Union to be providing services worth $8m a year—or $260,000 per square kilometre. These services include the cleaning of sewage and waste water from industry, as well as flood attenuation and the support of downstream fisheries. At the same time, the waste-water-processing capacity of a swamp in

Uganda was calculated to be even more valuable than this, at least per unit area. Its 5.5 square kilometres provided a service worth $2m.

When valuation has been done, payment can follow. In Cape Town, South Africa, for example, it proved cheaper to restore the town's watershed to its native vegetation than to divert water from elsewhere, or to create reservoirs. And there are a wide range of other cities and towns in the poor world that use ecological payments to protect their water supplies—from Quito in Ecuador with 1.2m people to Yamabal in El Salvador with only 3,800.

More complex benefits can be paid for in more complex ways. A scheme in Costa Rica, which costs $57m a year, is paid for partly by hydroelectric-power producers, who receive services such as stream-flow regulation, sediment retention and erosion control, partly by private consumers of water, who use it for irrigation, and partly by the country's government, in order to supply towns with water and maintain the area's scenic beauty for recreation and ecotourism.

Meanwhile in Colombia and France, there are schemes financed entirely by the private sector. Large agricultural producers in the Cauca Valley pay fees for watershed-management projects, such as erosion control and reforestation. And Perrier-Vittel, a bottler of mineral water, has found it necessary to reforest parts of heavily farmed watersheds and also to pay farmers to switch to modern facilities and organic farming in order to preserve the quality of some of its products.

Valuing ecosystem services can also point to places where inaction is best. After fires in Croatia had damaged many forests, a study was done to see if restoration was worthwhile given their value to the tourist industry. Examination of 11 sites revealed that the net benefits varied significantly (see chart). Some sites were not worthy candidates and were dropped.

As scientific understanding of ecological services improves, new financial opportunities emerge. For example, the importance of insect pollination to the quality and quantity of agricultural crops such as coffee, almonds and apples, has only recently become appreciated. Last year, a study in Costa Rica found that on one farm alone the natural pollination of coffee by insects was worth $60,000. Coffee yields were 20% higher on plots that lay within a kilometre of natural forest.

Simply having this kind of information could change the way that coffee farmers view areas such as forest and wild grasslands on or near their property. Looked at another way, it might encourage owners of forests that help to pollinate a neighbour's crops to demand payment. Indeed, a version of this sort of blackmail already happens on an international scale. Elliot Morley, Britain's minister for the environment, says that developing countries sometimes say to him, “give us the money or the forest gets it”.

The bee's knees

Putting a proper value on ecological services is bound up with another economic anomaly that haunts environmental economics. This is the creation of what economists term externalities—economic impacts made when those taking a decision do not bear all the costs (or reap all the gains) of their actions. When a piece of natural habitat is ploughed, for example, the conversion may make sense to the land owner, but it may also damage fisheries downstream, increase flooding and clog rivers with sediment. This makes those who lose out angry. It can also, in some circumstances, subtract from, rather than add to, a country's total wealth.

The problems discussed above all involve externalities as well as the need to price ecological services correctly. If Catskill farmers had not changed their methods, for example, New York City's government would not have faced the question of how to keep its water potable. But when an externality affects only a relatively small, recognisable group of people, negotiation between the

parties can often resolve the matter. If, however, an externality is a public “bad” (ie, the opposite of a public good), such deals are not possible.

Public goods are those which are in everybody's interest to have, but in no one's interest to provide. Clean air, for example, or, more controversially, the preservation of rare species of plant or animal.

In such situations, the first reaction is frequently to legislate to try to ban the externality. But a more efficient solution can often be what is known as a cap and trade scheme, in which legislation creates both an overall limit to the amount of the externality in question, whether it be a polluting chemical or the destruction of a type of habitat, and a market in the right to impose the externality within that limit.

Cap and trade schemes are best known in the context of polluting gases. Sulphur-dioxide-emission rights have been traded in America for years, and in countries that have signed up to the Kyoto protocol on climate change a market is starting to develop in carbon dioxide. But cap and trade can work in other contexts as well. Fisheries are a well-tested example, while in Australia, farmers who use irrigation (which increases soil salinity) can buy “transpiration credits” from forest owners whose trees, by sucking up water in the process known as transpiration, reduce salinity.

In America, similar markets in wetlands and endangered species have arisen. These are run through so-called mitigation banks. Such banks are created by permanently protecting privately owned swamps, or land that is inhabited by endangered species. This creates a supply of environmental “credits”. Those who want to destroy wetlands, or species-rich habitats, for agricultural or development purposes are able to buy credits from a mitigation bank allowing them to do so. New federal guidelines mean that mitigation banking is becoming popular in many American states. Indeed, it is even starting to finance the emergence of companies dedicated to restoring wetlands, or building them from scratch.

Such liquid markets are different from the fee-for-service arrangements that pertain to such things as watershed management. And, as if to underscore the arrival of environmental trading in the marketplace, two recent publications have been launched to track the field. Platts, best known for newsletters that report prices in energy markets, started a newsletter called *Emissions Daily* in February. This covers the carbon-dioxide market in Europe, and the sulphur-dioxide and nitrogen-oxide markets in America, publishing daily price assessments for the leading contracts. The second publication is a website called the Ecosystem Marketplace, which tracks markets and payment schemes for ecological services such as water quality, carbon sequestration (planting trees as a way of absorbing carbon dioxide from the atmosphere) and habitat preservation.

The principle having been established, traders are now looking for other opportunities to arbitrage pollution. One promising area is the trading of nitrate emissions between factories and farmers. Farmers' emissions are generally less regulated than those of factories but—probably because of that—farmers can often reduce their nitrate output at a fraction of the cost that a factory would have to incur. Trading between the two means that pollution standards can be met more cheaply.

The greening of the City

All these payments and new markets have not gone unnoticed in the City of London, and other financial centres. People there are watching closely for new financial opportunities, particularly within carbon-dioxide markets—and banks such as ABN AMRO plan to start selling “new environmental financial products”. While the City has little interest these days in specifically “green” investments, there is something of a greenward shift in the way its firms handle large-scale project finance. Almost two years ago, ten of the world's largest banks signed an agreement

to address the social and environmental impacts of the projects they financed (at least, those worth more than $50m). The rules were dubbed “The Equator Principles”, and 29 financial institutions have now adopted them. An article published this year in a *Euromoney* handbook estimated that such “Equator” banks represented about 75% of the project-finance market in 2003. In its sustainability report for 2004, ABN AMRO reviewed 16 deals that had been subjected to the Equator principles. One had been rejected. Four were approved. The rest were modified to fit in with the principles.

Is it working? Of course, banks are not keen to discuss their businesses in any detail, so there is no real way of knowing. It is easy to be cynical about the principles as little more than “greenwash”. Nevertheless, Mr Forgach explains that when projects are under consideration they have to be screened with a “green check”. He describes this as a series of questions, analyses and consultations on the impact a project will have on biodiversity, the climate and “footprint stuff” (a measure of the consumption of ecological resources).

From the perspective of someone wanting to borrow money, this means that green issues have to be considered from the beginning, and possibly even acted on. So, the proposers of a mining project might have to consider damage to the river and to downstream fisheries of any additional sediment the mine would produce. Borrowers may have to change their plans (as they did in 11 of ABN AMRO's deals last year) so that they are more environmentally friendly, or offset damage by protecting land elsewhere.

In effect, this means that the environment has been brought on to the balance sheet. Furthermore, because insurance companies recognise that the environment can be a huge portion of the risk in a project, there may be a financial incentive for paying to protect it.

Valuation is only ever part of the answer, because not everything is for sale. Mr Forgach says he has calculated that the Panamanians could get far more for their lovely fresh water by shutting down the canal, bottling the water and selling it. Running a canal is a crazy waste of water, he says, but America would not let Panama shut the canal.

Still, many conservationists dislike valuation. Some misunderstand it as an approach that ignores cultural and spiritual values. It does not. It simply converts these values into monetary units that can highlight the cost of a course of action. Of course, it might not be appropriate in some cases for this value to be a factor in making a conservation decision. For example, closing the canal and selling water, or building tower blocks on the site of St Paul's cathedral in London, might be perfectly rational from an economic perspective, but also very unlikely to happen.

The valuation of ecosystem services is not without its difficulties. Nevertheless, the fact that there is a growing consensus about how and where it is appropriate is an important step forward for economists and environmentalists. In 1817, David Ricardo, a pioneering economist, noted that abundance in nature was rarely rewarded: “where she is munificently beneficent she always works gratis.” But if nature pays, who then will pay for nature?

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Syria

Son of a gun

Apr 21st 2005
From The Economist print edition

Katz

America's ties with Syria have long been tricky. Two new books explain why the relationship needs to be made coherent before it can become more harmonious

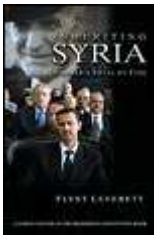
IF HAFEZ ASSAD bore a resemblance to Don Corleone in "The Godfather", then his heir, Bashar, Flynt Leverett suggests, could be the don's son. Like Michael Corleone, Bashar Assad is an improbable successor, who promised to make the family enterprise legitimate but who operates in an environment that obstructs any such transformation.

Five years into Bashar's reign, there is still little consensus about his beliefs on important issues or how much real power he exercises. His decision to withdraw Syrian troops from Lebanon by the end of April is a hopeful, but not conclusive, sign. With Syria increasingly isolated and facing unprecedented pressure, his father, too, might have found a tactical withdrawal to be expedient. Hafez Assad's foreign policy was ever a shrewd mix of confrontation and co-operation.

Bashar, unlike his father, has been exposed to western ways, and talks to westerners like a would-be reformer. But not much reform has happened. It is still unclear whether the younger Assad is held back by the Old Guard—the entrenched power structure bequeathed to him by his father—or whether the tortoise-like approach fits his own predilections.

The American administration is disinclined to give him the benefit of the

Inheriting Syria: Bashar's Trial by Fire
By Flynt Leverett



Brookings Institution Press; 296 pages; $27.95 and £16.99

Buy it at
Amazon.com
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Hizbullah: The Story from Within

doubt. Syria has long been an awkward customer: a smallish, militarily weak country with no resources to speak of but with a disproportionate ability to annoy. It has been on the State Department's list of states that sponsor terrorism since 1979, it is said to pursue WMD in the shape of chemical weapons and it has little truck with democracy. Yet it enjoys more or less normal diplomatic relations with the United States and, so far at least, suffers only mild economic sanctions.

American policy towards Syria is incoherent, according to Mr Leverett, who has held several senior jobs in Washington including running Middle Eastern affairs at the National Security Council. The administration simply cannot decide what to do. One, rather noisy, faction considers Syria ripe for coercive regime change. Another would rather continue ratcheting up economic, political and rhetorical pressure. Yet another believes that Syria should be offered a carrot-and-stick package similar to that which persuaded Libya to change some of its nastier ways.

By Naim Qassem

Saqi Books; 284 pages; £18. To be published in America by Saqi Books in July

Buy it at
Amazon.com
Amazon.co.uk

The author, writing from experience, advocates the third approach. It is not much good, he suggests, demanding, as the neoconservatives do, that Syria sever its ties to terrorist groups simply because this is "the right thing to do"; the Syrians have to be persuaded. He argues that judgment on Bashar should take the timing into account. He took over in June 2000, which marked the start of a particularly stormy period. The peace track with Israel had collapsed, the Palestinian *intifada* was about to explode and the terrorist attack on America was just over the horizon. The young Assad put stability first, believing, as the Middle East's monarchical leaders find it easy to believe, that there was no great hurry, let alone a fixed electoral term, to bring about change.

Any Syrian change for the better—whether it is more openness at home or less support for militant forces abroad—needs the basis of a sounder American-Syrian relationship. Mr Leverett would bring this about through what he calls "conditional engagement". In the 1990s the framework for Syrian-American relations was the Syrian-Israeli peace process. But that path is blocked. Syria insists that the first step must be Israel's reaffirmation of the "Rabin deposit" (the late Yitzhak Rabin's conditional willingness to withdraw fully from the Israeli-occupied Golan Heights). But Ariel Sharon, Israel's current prime minister, will reaffirm no such thing.

Conditional engagement, nowadays, would mean that Syria, in return for a more understanding American attitude, should agree to end its involvement with terrorism. If this means stricter control of the Syria-Iraq border, a bargain could probably be struck: Syria was careful, after September 2001, to show itself as being on the right side of the "war on terrorism", although it received few American thanks for doing so. But "terrorism", in American parlance, includes Hizbullah, the Syrian-supported Shia Muslim Lebanese party-cum-militia. The UN resolution that last year called on Syria to get out of Lebanon also demanded the disarming of Hizbullah, the only militia to be permitted to keep its arms at the end of Lebanon's civil war. The unwritten text was clear: Syria should not be allowed to get away with keeping an armed proxy in Lebanon.

This is more problematic. For a start, Bashar has a closer relationship with Hizbullah's leader, Hassan Nasrullah, than his father had. Hizbullah itself puts faith in the mutual need that Syria and Hizbullah have of each other. Sheikh Naim Qassem, who claims confidence in the solidity of the Syria-Hizbullah link, is very much an insider. He was a founding member of Hizbullah in 1982 and has been its deputy secretary-general since 1991.

Sheikh Qassem insists that Hizbullah, the party of God, should be seen as an Islamic party first and a resistance group second; its ideological commitment is what spurs it to refuse occupation. Though Hizbullah takes credit for throwing Israel out of Lebanon, the repercussions of Israeli

occupation still continue, he argues, in the refugees, the infringement of airspace, the appropriation of water resources, the retention of detainees and an Israeli presence in the sliver of land known as the Shebaa Farms. But what would Hizbullah do if Lebanon was completely liberated and all detainees were finally freed? Keep guessing, replies the wily sheikh, which may also be Bashar Assad's approach.

Inheriting Syria: Bashar's Trial by Fire.
By Flynt Leverett.
Brookings Institution Press; 296 pages; $27.95 and £16.99

By Naim Qassem.
Saqi Books; 284 pages; £18. To be published in America by Saqi Books in July

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Paris

La ville en rose

Apr 21st 2005
From The Economist print edition

THE sharp click of stiletto on pavement, the sweet, burnt warmth of the Métro: no capital evokes sensations in quite the same way as Paris. The city has been described so much, noted Baron de Pollnitz in 1732—and one has heard it talked about so often—that "most people know what the city looks like without ever having seen it". Each of these two volumes (one history, the other fiction) draws on elements of that mythologised Paris, while also trying to reach beyond it.

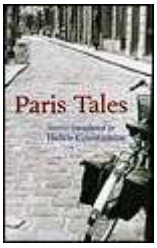
Helen Constantine has translated a collection of short stories, some of whose authors will be familiar to a non-French-speaker (Emile Zola, Colette), others less so (Frédéric Beigbeder, Maryse Condé). The result is a sort of literary guided tour of Paris: an accumulation of impressions, glances, thrills, disappointments, mapped out against the city. Romance and nostalgia naturally feature, even when Paris is but a backdrop. As Ms Constantine points out, the names of Paris stations alone evoke history or intrigue—the Gare Saint-Lazare and Réaumur-Sébastopol—in a way that London King's Cross, say, does not.

But the stories garner hostility, violence and loss in Paris too. In "A Parisian Adventure", Guy de Maupassant's provincial heroine seeks sexual adventure in the city. Her attempt to taste the sinful pleasures on the distant horizon ends in repulsion and regret, as she wakes with a "little fat man lying beside her, his distended belly making the sheet swell like a gas balloon". Georges Perec's carefully paced story, "The Runaway", painfully pieces together an adult's recollection of fleeing home as a child. As the young boy darts hesitantly about the city, waiting for someone to speak to him, see him—and fetch him back—Paris itself comes to embody loneliness, uncertainty, fear and cold.

Memory also stalks Colin Jones's work. A British historian who set out to write a biography, as opposed to a history, of Paris, Mr Jones draws inspiration from Georges Perec's 1975 micro-chronicle of a day in a Paris square, "Tentative d'Epuisement d'un Lieu Parisien", and Pierre Nora's critical study, "Les Lieux de Mémoire". The result is a wide-ranging work that moves from Roman rule to that of President Jacques Chirac, told not only as political narrative, but through the city's evolution in terms of ideas, arts and geography too.

There is still plenty for the traditionalist, from the account of the development of Paris under the Capetians to the radical urban planning of Baron Georges-Eugène Haussmann or the *grands projets* of Georges Pompidou and François Mitterrand. There are also separate boxes on such eclectic subjects as Saint Geneviève, Josephine Baker, the Café Procope and the *vespasiennes*

Paris Tales: Stories
By Translated by Helen Constantine



Oxford University Press; 246 pages; $16.95 and £9.99

Buy it at
Amazon.com
Amazon.co.uk

Paris: The Biography of a City
By Colin Jones

Viking; 566 pages; $29.95. Penguin/Allen Lane; £25

Buy it at
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(public urinals). These, Mr Jones explains in as much detail as one might ever want, were named after the Roman Emperor Vespasian, and numbered 4,000 by 1914. Installed during the second empire, along with lamp posts, benches, kiosks and water fountains, they formed part of the *embourgeoisement* of the Paris street. Architectural styles ranged from Gothic through classical to the baroque. By the mid-1950s, thanks to domestic sanitary improvements, the number of *vespasiennes* had dwindled to some 300. Scarcely one survives today.

Some questions are left tantalisingly unanswered. Why, for instance, from the 1970s onwards, did Paris come to lose its primary position as a world intellectual and artistic centre? With such ambition, though, omission is inevitable. A scholar, Mr Jones also manages to find an accessible voice that strays only occasionally into impenetrable academese, such as the Métro being "replete with a matrix of often arcane meanings" which "defy even the most assiduous of users". Ignore such nonsense, and enjoy instead a highly readable and illuminating canter through the history of a much-loved city.

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Translated by Helen Constantine.
Oxford University Press; 246 pages; $16.95 and £9.99

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Economist.com BOOKS & ARTS

Branding

The sweet success of smell

Apr 21st 2005
From The Economist print edition

IF BUSINESSMEN today have a philosopher's stone, it is branding. Just turn base running shoes, hotels, magazines, even yourself, into a brand and the gold will soon come rolling in. Just look at Gucci and Madonna. They are brands almost as much as they are anything else. And ain't they done well?

There are lots of books trying to distil the essence of this particular magic. "Brand Sense" stands out from the crowd for two reasons: it has a foreword by Philip Kotler, a professor at the Kellogg School of Management who is an acknowledged world master of marketing, in which he says the book "contains a treasury of ideas for bringing new life" to brands. And it has a flash of insight.

The author is an advertising executive who is worried about the industry's inability to wean itself off making advertisements for television, a medium that will soon be watched only by sozzled juveniles armed with the technology enabling them to skip the ads. In such a world, how can companies build new brands? Martin Lindstrom's answer is to make the brand "a sensory experience that extends beyond the traditional paradigm [based on print media and television], which primarily addresses sight and sound." Appeal to all five senses, he says. Give your brand a distinctive smell or texture.

Brand Sense: Build Powerful Brands through Touch, Taste, Smell, Sight, and Sound
By Martin Lindstrom

Simon & Schuster; 256 pages; $26.
Kogan Page; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Some forward-thinking companies are doing this already. The feel of a Bang & Olufsen remote control, the smell inside a Singapore Airlines cabin, the crunch of a Kellogg's cornflake and the sound of the closing of a Mercedes car door; all these "sensations" have been carefully designed to reinforce the brand's image. And they can have a Proustian power. Mr Lindstrom points out that Singapore Airlines is consistently voted the world's best airline, "despite the fact that their food is average and their leg room is no better than many of the other airlines that rank in the top 20". But perhaps it is the airline's exceptionally beautiful hostesses who are responsible.

Mr Lindstrom suggests that brandbuilders can learn from organised religion, where sensory experiences (the smell of incense, the cry of the muezzin or the taste of a sacramental wafer) have been blended for centuries to bind consumers closer to the faith. It is no coincidence that some of the brands that appeal strongly to a wide range of senses have themselves gained the power of religion. The Harley-Davidson bike, the Prada bag, the Apple Mac: all, in their way, have occasionally been touted as objects of worship.

By Martin Lindstrom.
Simon & Schuster; 256 pages; $26.
Kogan Page; £16.99

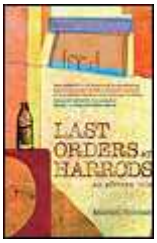
Fiction in Africa

Laughing at the hyenas

Apr 21st 2005
From The Economist print edition

"BUY this book or we shit in your car." Two African slum boys use a version of this threat—to great effect—as a way of fending off the police in Michael Holman's beautifully realised comic first novel, which may be one reason why he is planning to repeat it next month at the launch in Kenya of "Last Orders at Harrods". But there is more to Mr Holman's words than mere coprophilia.

Last Orders at Harrods: An African Tale
By Michael Holman



Polygon; 288 pages; £9.99

Buy it at
Amazon.co.uk

The two rats in question, Titus Ntoto and Cyrus Rutere, live in Kireba, a shantytown that abuts the capital of Kuwisha, a fictional African country. The boys have been taken under the wing of Charity Mupanga, the widowed owner of Harrods International Bar (and Nightspot), Kireba's most popular watering hole. Charity is a true African heroine in the mould of Alexander McCall Smith's Precious Ramotswe. She copes with erratic supplies of Worcestershire sauce (the secret ingredient in her recipe for fried chicken necks), takes floods and cholera in her stride, and marshals Ntoto, Rutere and the other local boys who have been orphaned by AIDS into peeling vegetables, washing dishes, running errands and learning to read.

They, in turn, pledge their support (and some ingenious assistance) when she begins receiving threatening letters from a firm of London lawyers claiming exclusive rights to the use of the first name of her late father, Harrods Tangwenya, gardener to successive British high commissioners for nearly 20 years. The lawyers try their hardest to bring Harrods to the brink of disaster, until the two slum boys help save the day.

"Last Orders", the first of a trilogy that will explore the rise and rise of Titus Ntoto, has given Mr Holman, who retired three years ago as Africa editor of the *Financial Times*, the chance to cast a more sardonic eye over the inspiring and ever-infuriating continent in which he was born—and the chance to do some good as well.

In Kenya, books are often too costly for African readers. So Mr Holman has persuaded his publishers to bring out a special edition of 1,000 copies of "Last Orders at Harrods", which will be printed locally and sold by Nairobi's street children for 200 Kenyan shillings ($2.65), about a tenth of the usual price. The kids will keep the proceeds. Be warned, though: they are tough little salesmen. So look out for your car.

By Michael Holman.
Polygon; 288 pages; £9.99

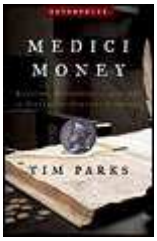
15th-century Florence

Medici moolah

Apr 21st 2005
From The Economist print edition

TIM PARKS is a polymath among authors. He is a prolific novelist. In Italy, where he lives, he is a translator, an essayist, a memoirist and a professor. He also writes authoritatively about football. The subject of his new book extends his range even further, though Cosimo and Lorenzo de Medici would make convincing fictional characters. They are the two greatest celebrities in the history of banking, rivalled only by Nathan Rothschild.

Medici Money: Banking, Metaphysics, and Art in Fifteenth-Century Florence
By Tim Parks



Norton; 224 pages; $22.95.
Profile Business; £11.19

Buy it at
Amazon.com
Amazon.co.uk

Cosimo was the Renaissance man, well-read, with educated taste in painting and sculpture, and immensely skilled at having his cake and eating it. (In an aside, Mr Parks reports that the equivalent Italian expression is to have your wife drunk and your wine keg full.) Cosimo's reward for financing the restoration of the convent church of San Marco in Florence was a Papal bull absolving him of his sins—each and every one. Cosimo's grandson, Lorenzo, known as the Magnificent—though that is how Medici bankers generally referred to the boss—was a great patron in the time of Ghirlandaio, Pollaiuolo, Botticelli and Leonardo, all Florentine painters of genius.

No doubt the Medicis truly appreciated art, but Mr Parks is under no illusions about the ultimate purpose of the family's patronage. It was designed to make Florentines feel so good about the city that they were willing to suppress their republican instincts, and surrender political power to the Medici. It was brilliantly done. Niccolò Machiavelli praised Cosimo's ability to mix power with grace. But one of his first acts on becoming leader in 1434 was to change the rules which had curtailed banking operations. Mr Parks is a quick study, and his explanation of bills of exchange and trade finance in 15th-century Europe is a model for all economic historians. Consequently, when he says that one of Cosimo's first actions was to legalise "dry exchange"—a clever banker's shortcut to escape the church's strict laws against usury—we understand that the inspiration is self-interest and the motive is profit. Mr Parks, who is sceptical about bankers, writes about them with pace, wit and some passion.

The Medici dynasty was not long-lived. It began with Cosimo's father in 1397 and ended in 1494 with the flight of Lorenzo's son, Piero. Mr Parks asserts that the bank's attraction to political power eventually proved fatal. No banker can be a prudent lender when he is buying influence in court and financing armies, and lending to clients who considered repayment somehow undignified.

By the time Lorenzo was in charge, he was not in control. Non-productive loans, such as those to an English king, Edward IV, by the London branch helped bring down the Medici Bank, just as Edward III's failure to repay huge Italian loans had destroyed the Bardi and Peruzzi banks in the 1340s.

But the collapse of the Medici bank was not the end of the line. Lorenzo had arranged for his younger son, Giovanni, to enter the priesthood at the age of eight, and had been able to promote the boy's elevation to cardinal when he was only 13. Giovanni went on to become Pope Leo X and nurtured the family's fortunes in Rome so well that Lorenzo's great grandson was able to return to Florence in 1537 as Duke Cosimo I. The second Medici dynasty had nothing to do with banking.

By Tim Parks.
Norton; 224 pages; $22.95.
Profile Business; £11.19

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Economist.com BOOKS & ARTS

The British election

What's going on

Apr 21st 2005
From The Economist print edition

New books to help you make sense out of the nonsense

THE most useful election books are those which chart the nuts and bolts of the electoral process. The seventh edition of **Elections in Britain: A Voter's Guide** (Palgrave Macmillan), by Dick Leonard and Roger Mortimore, is a straightforward factual account of how the British electoral system works. It deals with the rules and administrative arrangements, the casting and counting of ballots and how votes translate into seats, as well as the conduct and financing of the campaign itself. But it needs some updating since it does not evaluate the consequences of the Political Parties, Elections and Referendums Act 2000, which regulated national campaign spending, and provided for the establishment of a statutory Electoral Commission. The act also eased the restrictions on postal voting, a provision that has placed a large question mark over the probity of British electoral arrangements.

The Almanac of British Politics(Routledge), by Robert Waller and Byron Criddle and also in its seventh edition, is indispensable. It is modelled on Michael Barone's "The Almanac of American Politics", which has been published biennially for more than 30 years. The Almanac offers a complete guide to the electoral map of Britain, with profiles of every constituency and a biographical profile of every member of parliament. The constituency profiles are preceded by a fascinating series of tables relating social and economic factors to voting behaviour. These show, for example, the precipitous decline of Conservative support among the professional and managerial classes. Of the 20 constituencies with the highest proportion of professional and managerial voters, the Conservatives held just eight in 2001, while Labour won nine and the Liberal Democrats three.

Politico's Guide to the General Election 2005(Politico's), by Simon Henig and Lewis Baston, contains constituency profiles of the 200 most marginal constituencies. There are also valuable chapters on opinion polls by Roger Mortimore of MORI and on Labour rebellions by Philip Cowley and Mark Stuart. Despite the massive rebellions in Tony Blair's second term on such issues as Iraq, foundation hospitals and top-up fees, there has been no collapse in party discipline. Not many MPs have rebelled regularly, and even the most rebellious voted with their party more often than not. But few of the most consistent rebels sit for marginal seats, and so, if Labour's majority is drastically reduced, they will constitute a higher proportion of Labour MPs in the new parliament. This foreshadows trouble for Mr Blair.

In an earlier book, "Did Things Get Better?" (Penguin), written before the 2001 general election, Polly Toynbee and David Walker, two journalists on the *Guardian*, claimed that Mr Blair's historic achievement had been "to make Labour electable again". Their second volume, **Better or Worse? Has Labour Delivered?** (Bloomsbury), asks whether Labour has been worth electing. They pinpoint the paradox that, despite the barrage of statistics showing economic progress and improvements in the public services, there remains a gap between public perceptions and reality. Ms Toynbee and Mr Walker ask questions which are unlikely to be put during the campaign—in particular, what will happen to NHS spending when the rate of increase tails off after 2008, and, more generally, what role is there for the collective provision of public services in a post-

Thatcherite world? This is a well-informed, critical and sympathetic work, and by far the best book for anyone seeking to find out exactly what Labour has done with its huge majority in its second term.

Other election books may prove more ephemeral. The best account of the historic causes of the Conservative Party's troubles is **Recovering Power: The Conservatives in Opposition Since 1867** (Palgrave Macmillan). Edited by Stuart Ball and Anthony Seldon, it includes contributions by a number of different writers. **In Search of Michael Howard** (Simon & Schuster), by Michael Crick, shows that the Conservative leader, far from having "something of the night about him", in Ann Widdecombe's famous phrase, is a thoroughly respectable professional politician, with no obviously discernible core of belief. Meanwhile, Roy Douglas's **Liberals** (Hambledon and London), provides a straightforward history of the Liberals and Liberal Democrats, written by a sympathiser, and **Prolonged Labour: The Slow Birth of New Labour Britain** (Palgrave Macmillan), by David Coates, examines the politics and performance of the Blair administrations from a distinctly Old Labour perspective.

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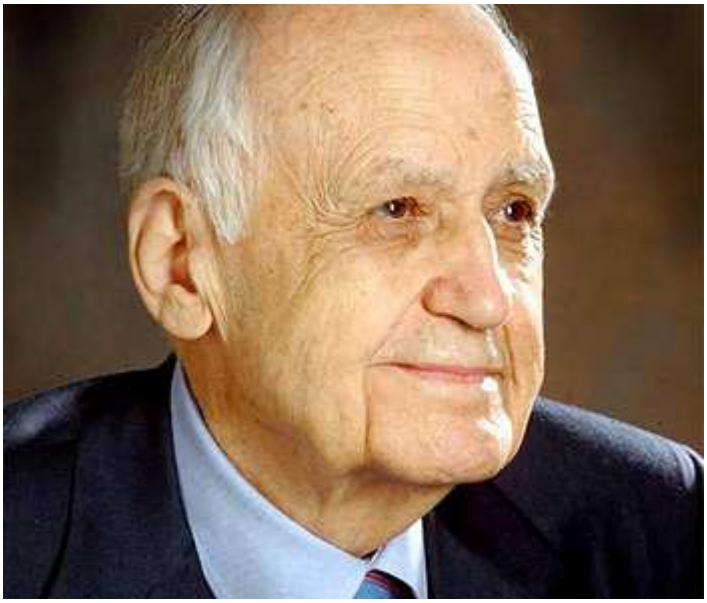
Obituary

Maurice Hilleman

Apr 21st 2005
From The Economist print edition



Maurice Hilleman, pioneer of preventive medicine, died on April 11th, aged 85

A STORY that Maurice Hilleman liked to tell to illustrate his work as a developer of vaccines concerned his daughter Jeryl Lynn. In 1963 at the age of five she caught mumps, a highly infectious disease of childhood that is usually benign but can be a killer. Mr Hilleman used swabs to collect the mumps virus growing in her throat, and preserved it in a jar of beef broth. He produced a form of the virus that was too weak to cause disease but strong enough to trigger the body's natural defences and make the person immune. The weakened strain, named after Jeryl Lynn, has become the standard vaccine to prevent mumps. The disease is now rare, at least in rich countries.

Identifying the problem, collecting data, finding a solution: Mr Hilleman developed some 40 vaccines, among them for measles, hepatitis A and B, chickenpox, meningitis and pneumonia. He developed the one-shot vaccine that can prevent several diseases, such as MMR (measles, mumps and rubella). When in 1988 President Reagan presented him with the National Medal of Science, America's highest scientific honour, it was said that he had saved more lives than any other scientist in the 20th century. His peers said that he had done more for preventive medicine than anyone since Louis Pasteur.

Even allowing for the hyperbole generated on such occasions the commendations were merited. Some said he should have had the Nobel. The same was said about Jonas Salk, who developed the first successful vaccine for polio. But the Nobel prizegivers tend to favour basic science rather than applied research. It was Pasteur (1822-95) who discovered that a weakened microbe could be used as an immunisation against its more virulent form, and all succeeding microbiologists have

had to live under his long shadow.

Waiting for bird flu

Mr Hilleman's greatest contribution to a healthy world may have been his work on the safe mass production of vaccines that can be stored ready for use against the pandemics that since antiquity have regularly swept across continents, such as the 1918 flu outbreak that killed more than 20m people. In 1957, when flu swept through Hong Kong, Mr Hilleman identified the virus as a new form to which people had no natural immunity and passed on his findings to vaccine-makers. When the virus reached the United States a few months later 40m doses of vaccine were ready to limit its damage. Mr Hilleman established that the flu virus is constantly mutating, making it difficult to provide a reliable vaccine. Developing a vaccine can be complex. His fellow-workers saw him as an artist as much as a scientist, bringing to his discipline an instinctive feeling of what would work. Following his guidelines, many nations are making large quantities of what they believe will be useful vaccines in the hope of defeating a possible pandemic of bird flu, should the virus spread from Asia.

Getting a vaccine through its numerous trials to be licenced for public use was the big thrill in Mr Hilleman's life, he said. It was like being young again, like being back in Miles City, his home town in Montana, when they had something to celebrate, such as building a barn. “Everyone would get together, sit on a log, get a fresh bucket of water and pass around a cup.” Did you say water?

Life was simple then, he said. He picked up things there that he could have learnt nowhere else, such as hypnotising a chicken, an animal that has, if involuntarily, contributed much to medical research. Miles City sounds primitive rather than simple. It had been a frontier town and the older inhabitants still told stories of Indian battles. Young Hilleman was poor. His mother and twin sister had died during his birth and he and his seven surviving siblings had been brought up on a farm by relations. At the age of 18 he was working in a shop.

For a young man who felt that life must have more to offer than selling goods to cowboys and their girlfriends, there were two glimpses of a more interesting world. One was his homemade radio, which could just pick up talk and music programmes broadcast from distant Chicago. The other was the local public library, where he found a copy of Darwin's “On the Origin of Species”, which had avoided the censorship of the town's fundamentalist church.

He did eventually escape, first to the local state university and then to the University of Chicago, where he studied microbiology. America was by then at war. Mr Hilleman's contribution to winning it was to develop vaccines to protect soldiers fighting in the Pacific. After the war he worked for the Walter Reed army medical centre and then joined Merck, a pharmaceutical company, which, over some 27 years, provided him with the facilities to explore the mysteries of immunology.

Mr Hilleman believed that science would eventually rid the world of disease, as it had disposed of smallpox in 1979 and is close to banishing polio. But the big killers, tuberculosis, malaria and AIDS, were holding out, especially AIDS. He was baffled that 18 years of research had not produced a vaccine to prevent HIV, which can lead to AIDS. Mr Hilleman, usually a gentle, patient man, got angry about this.

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Overview

Apr 21st 2005
From The Economist print edition

World **stockmarkets** stumbled. America's Dow Jones Industrial Average suffered its worst one-day fall in two years on April 15th, losing 1.9% of its value. European markets moved in sympathy, with Germany's DAX falling by 5.2% over the week. Japan's Nikkei also retreated by 4.7%.

Inflation rose strongly in America. Consumer prices surged by 0.6% in March, leaving them 3.1% higher than a year earlier. Energy prices rose by 4% in the same month. Core inflation, which excludes fuel and food, rose by 0.4% in March, the biggest monthly gain in over two years.

There were some signs of stagnation to accompany the inflation. **Housing starts** fell 17.6% in March, the biggest monthly decline since 1991. The Michigan **consumer confidence** index plunged in April to its lowest reading since 2003. **Industrial production**, however, was strong, growing by 3.9% in the year to March.

Such strength was lacking in **Japan**, where industrial production grew by 1% in the year to February. It was absent also from the **euro area**, where industrial production expanded by only 0.6% over the same period.

In **Britain**, inflation rose to 1.9% in the year to March, its quickest pace in seven years. According to the minutes of their April meeting, two of the nine members of the Bank of England's rate-setting committee voted for a rate rise.

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Output, demand and jobs

Apr 21st 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.5	Q4	+ 0.6	+ 2.6	+ 3.2	– 0.4	Q4	+ 2.2	Q4	5.1	Mar	5.6
Austria	+ 2.1	Q4	+ 1.1	+ 2.1	+ 2.1	+ 8.8	Jan	– 1.2	Jan	4.6	Mar	4.5
Belgium	+ 2.6	Q4	+ 1.6	+ 2.1	+ 2.2	– 1.0	Feb	– 4.2	Jan	12.6	Mar†	12.7
Britain	+ 2.9	Q4	+ 2.9	+ 2.5	+ 2.2	– 0.1	Feb	+ 2.7	Mar	4.8	Feb††	4.8
Canada	+ 3.0	Q4	+ 1.7	+ 2.7	+ 3.0	+ 3.7	Jan	+ 6.5	Jan	6.9	Mar	7.3
Denmark	+ 2.9	Q4	+ 3.2	+ 2.1	+ 2.2	– 4.9	Feb	+ 6.3	Feb	5.9	Feb	6.6
France	+ 2.4	Q4	+ 3.5	+ 2.0	+ 2.1	+ 1.2	Feb	+ 2.1	Feb	10.1	Feb	9.8
Germany	+ 1.5	Q4	– 0.9	+ 0.9	+ 1.5	+ 1.5	Feb	– 1.1	Jan	12.0	Mar§	10.4
Italy	+ 0.8	Q4	– 1.7	+ 1.0	+ 1.5	– 2.5	Feb	– 3.1	Jan	8.0	Dec	8.2
Japan	+ 0.8	Q4	+ 0.5	+ 1.1	+ 1.9	+ 1.0	Feb	+ 1.2	Feb	4.7	Feb	5.0
Netherlands	+ 1.6	Q4	+ 0.1	+ 1.1	+ 1.7	+ 0.1	Feb	– 2.1	Jan†	6.6	Mar**	6.4
Spain	+ 2.7	Q4	+ 3.4	+ 2.7	+ 2.6	– 0.7	Feb	+ 2.4	Feb	10.3	Feb	11.1
Sweden	+ 2.0	Q4	+ 1.4	+ 2.7	+ 2.7	+ 2.9	Feb	+ 4.3	Feb	5.7	Feb†	6.0
Switzerland	+ 1.2	Q4	– 0.3	+ 1.3	+ 1.8	+ 4.7	Q4	– 3.0	Feb	3.9	Mar†	4.1
United States	+ 3.9	Q4	+ 3.8	+ 3.7	+ 3.2	+ 3.9	Mar	+ 5.3	Feb	5.2	Mar	5.7
Euro area	+ 1.8	Q4	+ 0.8	+ 1.5	+ 1.9	+ 0.6	Feb	+ 1.0	Feb	8.9	Feb	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 3.6	Q4	+ 2.5	na	na	– 0.7	Feb	+ 5.9	Feb	9.2	Feb†	9.0
Greece	+ 4.2	Q4	na	na	na	– 1.5	Feb	– 2.9	Jan	10.5	Jun	9.6
Iceland	+ 3.8	Q4	na	na	na	na		na		2.8	Feb†	3.6
Ireland	+ 2.8	Q4	na	na	na	– 5.7	Feb	+ 8.6	Feb	4.3	Mar	4.6
Luxembourg	+ 2.12003		na	na	na	+ 1.8	Jan	– 2.6	Feb	4.7	Feb	4.3
New Zealand	+ 3.6	Q4	+ 2.4	na	na	+ 3.5	Q4	+ 6.8	Q4	3.6	Q4	4.5
Norway	+ 3.2	Q4	+ 6.1	na	na	– 2.0	Feb	+ 5.9	Feb	3.7	Mar‡	3.9
Portugal	+ 0.6	Q4	– 1.1	na	na	+ 0.7	Feb	+ 3.7	Feb	7.1	Q4†	6.5

*% change on previous quarter at an annual rate. † Not seasonally adjusted. ‡ New series. †† Dec-Feb; claimant count rate 2.7% in Mar. § EU harmonised rate 9.7% in Feb. **Jan-Mar.

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Prices and wages

Apr 21st 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 2.6	Q4	+ 2.4	+ 2.6	+ 2.7	+ 8.2	Q4	– 1.1	+ 3.0	Q4	+ 6.0
Austria	+ 2.9	Mar	+ 1.5	+ 2.0	+ 1.6	+ 4.0	Mar	+ 3.0	+ 2.2	Mar	+ 2.1
Belgium	+ 3.1	Mar	+ 1.1	+ 1.9	+ 1.7	– 1.1	Feb	+ 2.4	+ 2.3	Jan	+ 1.9
Britain	+ 1.9	Mar*	+ 1.1	+ 1.8	+ 1.8	+ 2.8	Mar	+ 1.4	+ 4.7	Feb†	+ 4.9
Canada	+ 2.1	Feb	+ 0.7	+ 1.9	+ 2.1	+ 2.3	Feb	– 1.9	+ 1.8	Jan	+ 4.3
Denmark	+ 1.4	Mar	+ 0.7	+ 1.5	+ 1.8	+ 4.2	Mar	+ 0.3	+ 2.8	Q4	+ 3.5
France	+ 1.9	Mar	+ 1.7	+ 1.6	+ 1.6	+ 3.1	Feb	nil	+ 3.0	Q4	+ 2.7
Germany	+ 1.8	Mar	+ 1.1	+ 1.3	+ 1.1	+ 3.3	Mar	+ 1.0	+ 1.2	Jan	+ 1.9
Italy	+ 1.9	Mar	+ 2.3	+ 1.9	+ 1.9	+ 4.7	Feb	+ 0.1	+ 3.4	Feb	+ 2.8
Japan	– 0.3	Feb	nil	nil	+ 0.3	+ 1.4	Mar	+ 0.2	+ 0.1	Feb	+ 2.0
Netherlands	+ 1.8	Mar	+ 1.1	+ 1.3	+ 1.4	+ 5.5	Feb	– 1.6	+ 0.9	Mar	+ 1.7
Spain	+ 3.4	Mar	+ 2.1	+ 2.8	+ 2.6	+ 4.9	Feb	+ 0.7	+ 2.6	Q4	+ 3.3
Sweden	+ 0.1	Mar	– 0.1	+ 0.7	+ 1.5	+ 2.8	Feb	– 2.3	+ 2.0	Dec	+ 2.8
Switzerland	+ 1.4	Mar	– 0.1	+ 1.1	+ 1.2	+ 1.4	Mar	– 0.1	+ 1.4	2003	+ 1.8
United States	+ 3.1	Mar	+ 1.7	+ 2.6	+ 2.5	+ 4.9	Mar	+ 1.5	+ 2.6	Mar	+ 1.8
Euro area	+ 2.1	Mar	+ 1.7	+ 1.8	+ 1.6	+ 4.2	Feb	nil	+ 2.2	Q4	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.0	Mar	– 0.6	na	na	+ 2.4	Mar	– 0.6	+ 3.0	Q4	+ 4.2
Greece	+ 2.9	Mar	+ 2.7	na	na	+ 3.3	Jan	+ 1.5	na		na
Iceland	+ 4.3	Apr	+ 2.2	na	na	+ 6.6	Apr	+ 2.7	+ 6.7	Feb	+ 3.3
Ireland	+ 2.1	Mar	+ 1.3	na	na	– 0.4	Feb	– 6.6	+ 5.1	Q4	+ 4.5
Luxembourg	+ 2.4	Mar	+ 1.8	na	na	+16.3	Feb	– 0.6	nil	Jan	+ 2.6
New Zealand	+ 2.8	Q1	+ 1.5	na	na	+ 3.4	Q4	– 0.1	+ 2.5	Q4	+ 2.3
Norway	+ 1.0	Mar	– 0.6	na	na	+17.5	Mar	+ 3.3	+ 3.9	Q4	+ 3.9
Portugal	+ 2.2	Mar	+ 2.3	na	na	+ 4.0	Feb	– 0.5	– 0.9	Feb	+ 0.8

*RPI inflation rate 3.2% in Mar. †Dec-Feb.

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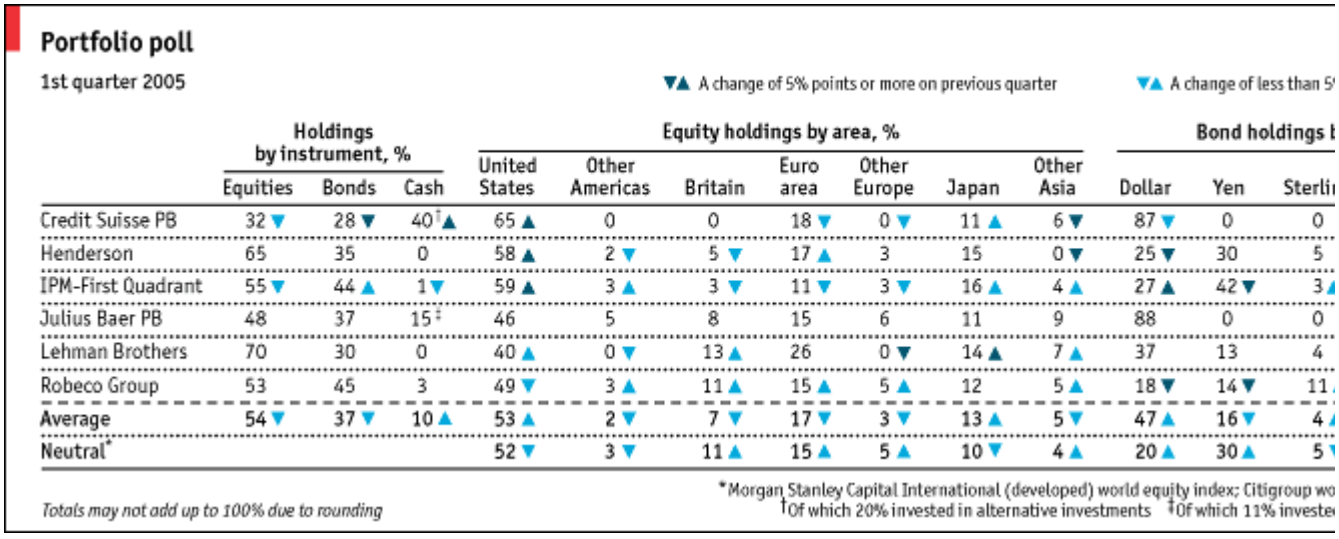
Portfolio poll

Apr 21st 2005
From The Economist print edition



Portfolio poll

1st quarter 2005

▼▲ A change of 5% points or more on previous quarter ▼▲ A change of less than 5

	Holdings by instrument, %			Equity holdings by area, %							Bond holdings b		
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia	Dollar	Yen	Sterli
Credit Suisse PB	32 ▼	28 ▼	40†▲	65 ▲	0	0	18 ▼	0 ▼	11 ▲	6 ▼	87 ▼	0	0
Henderson	65	35	0	58 ▲	2 ▼	5 ▼	17 ▲	3	15	0 ▼	25 ▼	30	5
IPM-First Quadrant	55 ▼	44 ▲	1 ▼	59 ▲	3 ▲	3 ▼	11 ▼	3 ▼	16 ▲	4 ▲	27 ▲	42 ▼	3 ▲
Julius Baer PB	48	37	15‡	46	5	8	15	6	11	9	88	0	0
Lehman Brothers	70	30	0	40 ▲	0 ▼	13 ▲	26	0 ▼	14 ▲	7 ▲	37	13	4
Robeco Group	53	45	3	49 ▼	3 ▲	11 ▲	15 ▲	5 ▲	12	5 ▲	18 ▼	14 ▼	11 ▲
Average	54 ▼	37 ▼	10 ▲	53 ▲	2 ▼	7 ▼	17 ▼	3 ▼	13 ▲	5 ▼	47 ▲	16 ▼	4 ▲
Neutral*				52 ▼	3 ▼	11 ▲	15 ▲	5 ▲	10 ▼	4 ▲	20 ▲	30 ▲	5 ▼

Totals may not add up to 100% due to rounding

*Morgan Stanley Capital International (developed) world equity index; Citigroup wo
†Of which 20% invested in alternative investments ‡Of which 11% investe

The money managers in our quarterly poll made few shifts among asset classes in the first quarter of the year. Credit Suisse was an exception: it reduced its exposure to bonds and equities, and boosted its allocation to cash by over five percentage-points. Within equities, however, the bank was one of several asset managers to strongly increase its exposure to American shares. Lehman Brothers and two other managers boosted their allocations to Japanese equities. There was little agreement within bond portfolios. Henderson, Credit Suisse and Robeco Group reduced their allocations to dollar-denominated bonds and opted for more euro-area bonds instead (Robeco already keeps more than half its bonds denominated in euros). IPM-First Quadrant made the opposite moves; it also dropped its allocations to yen-denominated bonds by over five percentage-points.

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Money and interest rates

Apr 21st 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Apr 20th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 2.0	+ 8.9	Feb	5.72	5.54	5.25	5.34	5.93	6.35
Britain	+ 5.2	+10.4	Mar	4.88	4.34	4.59	4.58	4.97	5.22
Canada	+13.7	+11.1	Feb	2.44	1.96	2.97	4.19	4.65	5.61
Denmark	+13.8	+10.3	Feb	2.18	2.15	2.28	3.49	4.28	5.01
Japan	+ 4.5	+ 2.1	Mar	0.02	0.02	0.08	1.25	1.56	1.34
Sweden	+ 2.5	+ 4.3	Feb	1.97	2.01	2.39	3.51	4.55	3.28‡
Switzerland	- 5.6	+ 2.0	Mar	0.76	0.28	0.94	2.06	2.67	1.99
United States	+ 3.3	+ 4.9	Mar	3.05	1.08	3.51	4.21	4.42	5.23
Euro area†	+ 9.9	+ 6.4	Feb	2.14	2.07	2.31	3.42	4.11	3.89

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. ‡ New series. Benchmarks: US 30-year 4.57%, Japan No. 269 1.25%. Central bank rates: US fed funds 2.75%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Apr 21st 2005
From The Economist print edition

2000=100

	Apr 12th	Apr 19th*	% change on one month	% change on one year
Dollar index				
All items	134.7	133.7	– 3.3	– 4.3
Food	126.1	127.5	– 4.0	– 9.4
Industrials				
All	145.8	141.7	– 2.5	+ 2.3
Nfa†	129.6	130.1	– 1.1	– 9.4
Metals	154.7	148.1	– 3.1	+ 9.1
Sterling index				
All items	108.3	105.8	– 4.2	–10.5
Euro index				
All items	96.7	94.9	– 2.1	–12.6
Yen index				
All items	135.3	132.9	– 1.4	– 5.3
Gold				
$ per oz	427.30	432.50	+ 0.3	+ 8.7
West Texas Intermediate				
$ per barrel	51.66	52.28	– 3.7	+40.5

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Apr 21st 2005
From The Economist print edition

Market indices

	Apr 20th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,001.0	4,255.8	3,936.5	– 2.8	– 6.0	– 1.3	– 2.5
Austria (ATX)	2,612.5	2,781.6	2,415.0	– 4.3	– 6.1	+ 7.4	+ 3.3
Belgium (Bel 20)	3,068.5	3,197.3	2,958.8	– 4.0	–16.7	+ 4.6	+ 0.6
Britain (FTSE 100)	4,822.0	5,060.8	4,783.6	– 2.8	–30.4	+ 0.2	nil
Canada (Toronto Composite)	9,378.1	9,927.2	9,006.2	– 1.2	–17.7	+ 1.4	– 2.0
Denmark (KBX)	288.2	294.6	257.8	– 2.0	– 4.5	+11.8	+ 7.3
France (SBF 250)	2,738.6	2,855.6	2,633.6	– 4.0	–37.6	+ 4.0	nil
(CAC 40)	3,950.0	4,124.4	3,816.1	– 4.1	–42.9	+ 3.4	– 0.6
Germany (DAX)	4,178.6	4,428.1	4,178.6	– 5.2	–48.2	– 1.8	– 5.6
Italy (S&P/MIB)*	31,025.0	32,856.0	30,645.0	– 5.1	–38.1	+ 0.4	– 3.5
Japan (Nikkei 225)	11,088.6	11,966.7	10,938.4	– 4.7	–71.5	– 3.5	– 7.5
(Topix)	1,131.5	1,203.3	1,109.5	– 3.8	–60.8	– 1.6	– 5.7
Netherlands (AEX)	353.9	379.8	350.1	– 4.5	–49.6	+ 1.7	– 2.3
Spain (Madrid SE)	972.4	1,025.8	950.9	– 3.5	–15.2	+ 1.4	– 2.5
Sweden (Affarsvarlden Gen)	234.0	240.4	218.9	– 2.3	–41.5	+ 5.8	nil
Switzerland (Swiss Market)	5,914.7	6,030.5	5,669.6	– 1.6	–29.7	+ 3.9	+ 0.1
United States (DJIA)	10,012.4	10,940.6	10,012.4	– 3.8	–14.6	– 7.1	– 7.1
(S&P 500)	1,137.5	1,225.3	1,137.5	– 3.1	–25.5	– 6.1	– 6.1
(NASDAQ Comp)	1,913.8	2,152.2	1,908.2	– 3.1	–62.1	–12.0	–12.0
Europe (FTSEurofirst 300)†	1,064.6	1,107.6	1,038.6	– 3.4	–37.6	+ 2.2	– 1.7
Euro area (FTSE Euro 100)†	901.8	952.4	894.4	– 4.4	–41.8	+ 0.1	– 3.8
World (MSCI)‡	1,118.6	1,193.0	1,117.1	– 2.7	–22.8	– 4.3	– 4.3
World bond market (Citigroup)††	656.8	662.3	642.6	+ 1.3	– 0.8	– 1.4	– 1.4

*New index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Apr 21st 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Apr 20th	year ago	Currency units per $ Apr 20th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 18.1	Feb	− 39.4	Q4	− 5.7	− 5.1	115.3	114.7	1.29	1.36	2.48	1.69	1.21	+ 0.7
Austria	+ 0.1	Jan	− 0.9	Feb	− 0.6	− 0.8	105.8§	105.5	0.77	0.84	1.47	–	0.72	− 1.5
Belgium	+ 17.6	Feb	+ 12.0	Dec	+ 3.3	+ 3.3	107.7§	107.2	0.77	0.84	1.47	–	0.72	− 0.1
Britain	−107.3	Feb	− 49.0	Q4	− 2.7	− 2.7	101.6**	100.5	0.52	0.56	–	0.68	0.49	− 3.2
Canada	+ 50.9	Feb	+ 23.4	Q4	+ 1.7	+ 1.5	115.3	106.7	1.24	1.36	2.38	1.62	1.16	+ 1.1
Denmark	+ 9.4	Feb	+ 7.2	Feb	+ 2.2	+ 2.1	106.5	105.5	5.70	6.27	10.9	7.45	5.33	+ 0.9
France	− 15.2	Feb	− 9.6	Feb	− 0.2	− 0.1	108.6§	108.0	0.77	0.84	1.47	–	0.72	− 3.7
Germany	+198.3	Feb	+107.5	Feb	+ 3.1	+ 3.0	110.2§	109.6	0.77	0.84	1.47	–	0.72	− 3.9
Italy	− 2.3	Feb	− 16.8	Feb	− 1.0	− 1.0	108.1§	107.6	0.77	0.84	1.47	–	0.72	− 2.9
Japan	+126.6	Feb	+169.5	Feb	+ 3.5	+ 3.6	86.9	88.8	107	109	205	140	–	− 6.5
Netherlands	+ 37.6	Feb	+ 24.1	Q4	+ 3.3	+ 3.3	108.5§	108.0	0.77	0.84	1.47	–	0.72	− 2.9
Spain	− 78.0	Jan	− 53.8	Jan	− 4.5	− 4.5	106.0§	105.6	0.77	0.84	1.47	–	0.72	− 1.1
Sweden	+ 22.8	Feb	+ 28.0	Q4	+ 6.8	+ 6.3	98.9	97.5	7.03	7.72	13.5	9.19	6.58	+ 0.5
Switzerland	+ 7.0	Mar	+ 40.8	Q4	+11.5	+11.5	108.0	105.0	1.18	1.32	2.26	1.54	1.10	− 1.6
United States	−693.1	Feb	−665.9	Q4	− 6.1	− 5.9	82.6	88.6	–	–	1.92	1.31	0.94	− 4.4
Euro area	+ 82.0	Feb	+ 46.1	Jan	+ 0.5	+ 0.5	118.6	113.9	0.77	0.84	1.47	–	0.72	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.0	Feb	+ 8.5	Feb	na	na	109.2§	108.9	0.77	0.84	1.47	–	0.72	+ 2.3
Greece	− 32.1	Jan	− 10.5	Feb	na	na	104.9§	104.6	0.77	0.84	1.47	–	0.72	− 5.3
Iceland	− 0.6	Feb	− 1.0	Q4	na	na	98.1††	90.2	62.5	73.6	120	81.7	58.5	+ 0.1
Ireland	+ 41.4	Feb	− 0.8	Q4	na	na	114.2§	113.1	0.77	0.84	1.47	–	0.72	+ 0.2
Luxembourg	− 4.6	Jan	+ 2.9	Q4	na	na	107.7§	107.2	0.77	0.84	1.47	–	0.72	− 0.4
New Zealand	− 2.8	Feb	− 6.2	Q4	na	na	137.5	123.8	1.38	1.60	2.64	1.80	1.29	+ 2.9
Norway	+ 36.5	Mar	+ 34.4	Dec	na	na	107.3	104.3	6.25	6.96	12.0	8.17	5.85	+ 8.2
Portugal	− 19.2	Jan	− 13.6	Jan	na	na	105.8††	105.1	0.77	0.84	1.47	–	0.72	− 2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD estimate. **New series. ††IMF, December average.

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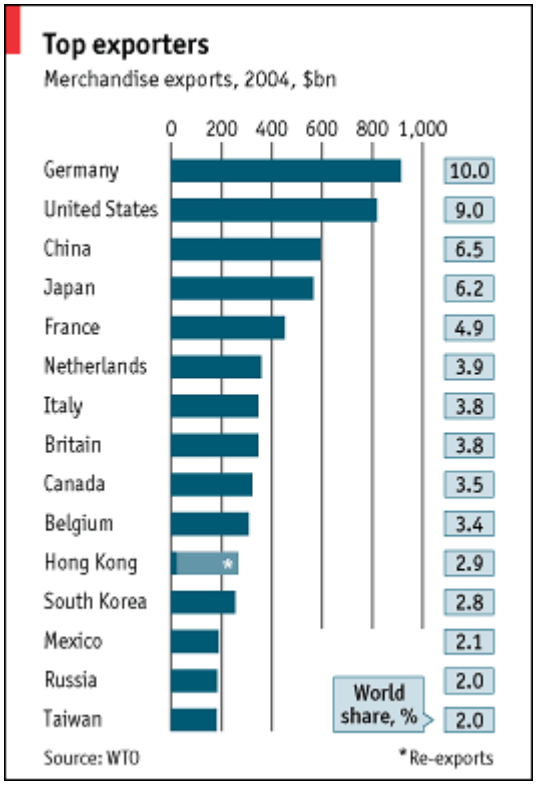
Top exporters

Apr 21st 2005
From The Economist print edition



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Overview

Apr 21st 2005
From The Economist print edition

China's economy grew by 9.5% in the year to March. A rise in consumption and exports, rather than excess investment, fuelled the growth. Meanwhile, consumer-price inflation dropped back to 2.7% in the year to March, from 3.9% the month before.

South Korea's foreign reserves climbed to $205.4 billion in March.

Peru's economy grew by 6.8% in the 12 months ending in February. **Mexico's** trade deficit swelled to $9.9 billion over the same period.

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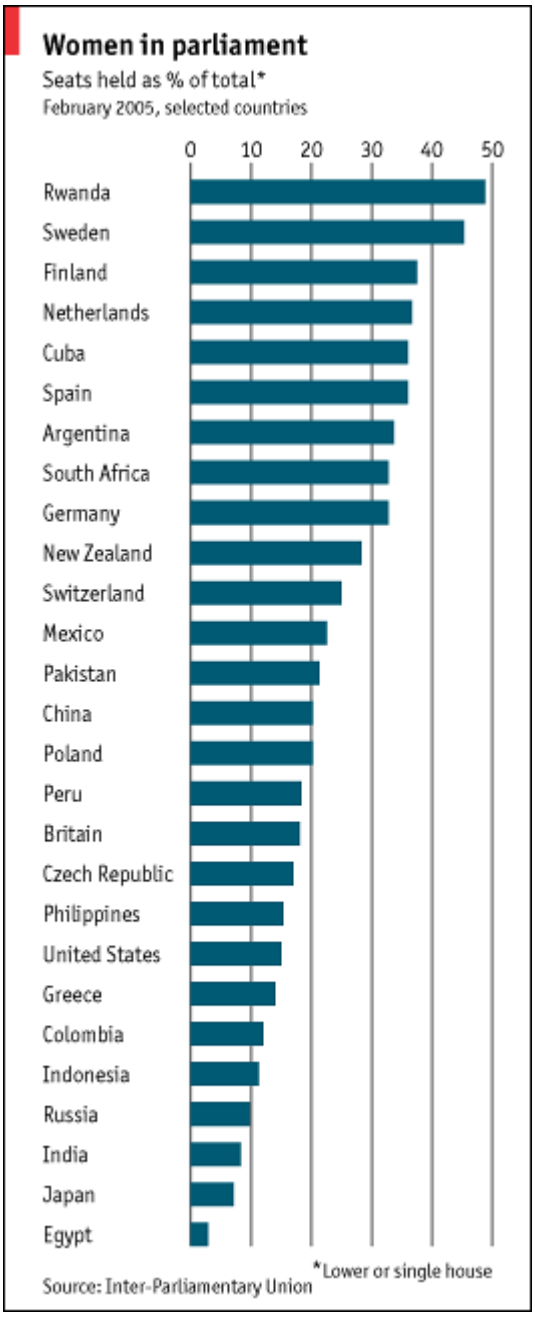
Women in parliament

Apr 21st 2005
From The Economist print edition

Rwanda heads the international league table for female representatives in national parliaments. Its pole position reflects the grip of the ruling party over parliamentary nominations. Sweden, Norway and Finland have the highest proportions of women in parliament after Rwanda. On average, women account for 16% of the world's parliamentary representatives.



Economy

Apr 21st 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q1	+15.1	Mar	+ 2.7	Mar	+57.3	Mar	+45.9	2003	659.1	Mar
Hong Kong	+ 7.1	Q4	+ 5.0	Q4	+ 0.8	Feb	−11.2	Feb	+16.0	Q4	122.4	Mar
India	+ 6.2	Q4	+ 4.9	Feb	+ 4.2	Feb	−25.0	Feb	− 3.9	Q4	135.3	Mar
Indonesia	+ 6.7	Q4	− 5.7	Jan	+ 8.8	Mar	+26.7	Feb	+ 2.9	Q4	35.2	Feb
Malaysia	+ 5.6	Q4	+ 8.5	Feb	+ 2.6	Mar	+21.9	Feb	+15.1	Q4	71.0	Feb
Philippines	+ 5.4	Q4	+ 5.5	Jan	+ 8.5	Mar†	− 0.2	Jan	+ 2.1	Dec	13.8	Mar
Singapore	+ 2.4	Q1	−10.2	Feb	nil	Feb	+15.8	Mar	+27.9	Q4	112.9	Mar
South Korea	+ 3.3	Q4	− 7.3	Feb	+ 3.1	Mar	+29.7	Mar	+27.3	Feb	205.4	Mar
Taiwan	+ 3.3	Q4	− 0.8	Mar	+ 2.3	Mar	+ 4.5	Mar	+19.0	Q4	251.1	Mar
Thailand	+ 5.1	Q4	− 1.8	Feb	+ 3.2	Mar	− 0.9	Feb	+ 4.5	Mar	48.5	Feb
Argentina	+ 8.4	Q4	+ 4.8	Feb	+ 9.1	Mar	+12.0	Feb	+ 3.0	Q4	20.0	Feb
Brazil	+ 4.9	Q4	+ 4.4	Feb	+ 7.5	Mar	+35.9	Mar	+11.7	Feb	58.5	Feb
Chile	+ 7.3	Q4	+ 3.5	Feb	+ 2.4	Mar	+ 9.0	Mar	+ 1.4	Q4	15.4	Mar
Colombia	+ 4.3	Q4	+ 2.0	Jan	+ 5.0	Mar	+ 0.9	Dec	− 1.1	Q4	12.6	Mar
Mexico	+ 4.9	Q4	+ 2.0	Feb	+ 4.4	Mar	− 9.9	Feb	− 8.7	Q4	64.0	Feb
Peru	+ 6.8	Feb	+ 3.3	Jan	+ 1.9	Mar	+ 3.0	Feb	− 0.1	Q4	13.6	Mar
Venezuela	+11.2	Q4	+ 8.9	Jan	+15.8	Mar	+22.1	Q4	+14.6	Q4	18.4	Dec
Egypt	+ 4.7	Q4	+ 3.3	2004‡	+ 9.5	Jan	− 9.0	Q4	+ 4.3	Q4	15.7	Feb
Israel	+ 4.8	Q4	+ 6.4	Jan	+ 0.7	Mar	− 7.0	Mar	+ 0.5	Q4	27.1	Mar
South Africa	+ 4.7	Q4	+ 2.7	Feb	+ 2.6	Feb	− 2.6	Feb	− 7.0	Q4	14.2	Mar
Czech Republic	+ 4.3	Q4	+ 5.6	Feb	+ 1.5	Mar	− 0.7	Feb	− 5.6	Q4	27.5	Mar
Hungary	+ 3.8	Q4	+ 1.3	Feb	+ 3.5	Mar	− 2.9	Q4	− 8.8	Q4	17.3	Mar
Poland	+ 3.9	Q4	+ 2.1	Feb	+ 3.4	Mar	− 5.0	Jan	− 3.6	Jan	41.1	Feb
Russia	+ 6.7	Q4	+ 5.1	Feb	+12.8	Feb	+93.3	Feb	+60.1	Q4	133.7	Mar
Turkey	+ 6.3	Q4	+14.9	Feb	+ 7.9	Mar	−35.4	Feb	−16.4	Feb	36.7	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.8	Q4	+ 6.8	Feb	+ 5.0	Mar	− 2.5	Jan	− 1.4	Q4	1.6	Feb
Latvia	+ 8.6	Q4	+ 1.3	Feb	+ 6.4	Mar	− 2.8	Feb	− 1.7	Feb	2.0	Feb
Lithuania	+ 6.7	Q4	na		+ 3.2	Mar	− 3.0	Feb	− 1.6	Q4	3.6	Feb
Slovakia	+ 5.8	Q4	nil	Feb	+ 2.5	Mar	− 1.6	Feb	− 1.5	Dec	16.7	Feb
Slovenia	+ 4.3	Q4	+ 0.5	Feb	+ 3.1	Mar	− 1.6	Feb	− 0.3	Feb	8.6	Jan
Pakistan	+ 6.4	2004‡	+28.3	Nov	+10.2	Mar	− 6.0	Mar	− 0.9	Q4	10.5	Feb
Saudi Arabia	+ 5.3	2004	na		+ 0.8	Jan	+68.5	2004	+28.0	2003	24.7	Jan

*Excluding gold, except Singapore; IMF definition. †New series ‡Year ending June, new series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

Financial markets

Apr 21st 2005
From The Economist print edition

	Currency units per $ Apr 20th	Currency units per $ year ago	Currency units per £ Apr 20th	Interest rates short-term % a year	Stockmarkets Apr 20th	% change on one week	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
China	8.28	8.28	15.9	2.20	1,242.0	-5.1	- 6.6	- 6.6
Hong Kong	7.80	7.80	15.0	2.29	13,501.6	-2.2	- 5.1	- 5.4
India	43.7	44.0	83.8	5.31	6,243.7	-3.5	- 5.4	- 5.9
Indonesia	9,585	8,651	18,373	7.72	1,070.9	-4.1	+ 7.1	+ 3.7
Malaysia	3.80	3.80	7.28	2.82	871.9	-0.3	- 3.9	- 3.9
Philippines	54.4	55.8	104.2	6.00	1,855.0	-3.2	+ 1.8	+ 5.1
Singapore	1.65	1.69	3.16	2.13	2,129.3	-2.1	+ 3.1	+ 2.1
South Korea	1,011	1,155	1,937	3.51	937.4	-4.5	+ 4.6	+ 7.2
Taiwan	31.5	32.9	60.3	1.40	5,693.0	-5.1	- 7.3	- 6.6
Thailand	39.4	39.5	75.5	2.65	684.2	-2.0	+ 2.4	+ 1.0
Argentina	2.90	2.85	5.56	4.63	1,309.5	-2.6	- 4.8	- 2.5
Brazil	22.55	2.93	43.23	19.24	25,062.4	-3.9	- 4.3	- 88.7
Chile	577	608	1,106	3.48	9,375.3	-0.9	+ 4.6	+ 0.7
Colombia	2,343	2,626	4,490	7.25	4,751.9	-1.4	+ 9.3	+ 9.8
Mexico	11.1	11.3	21.2	9.66	11,842.7	-4.7	- 8.3	- 7.6
Peru	3.26	4.00	6.25	3.01	4,100.3	+0.6	+ 10.5	+ 11.2
Venezuela	2,750§	3,055§	5,271	12.70	27,105.9	+0.5	- 9.5	- 15.2
Egypt	5.80	6.20	11.12	10.58**	34,157.8	-1.6	+ 38.9	+ 45.4
Israel	4.37	4.57	8.37	na	673.8	-1.0	+ 4.7	+ 3.5
South Africa	6.13	6.72	11.7	7.10	12,897.7	-0.9	+ 1.9	- 6.3
Czech Republic	23.1	27.4	44.2	2.03	1,163.8	-3.0	+ 12.8	+ 9.2
Hungary	190	211	364	7.69	16,613.7	-5.0	+ 12.7	+ 7.3
Poland	3.18	4.00	6.10	5.50	26,082.7	-4.5	- 2.1	- 7.9
Russia	27.7	28.9	53.1	13.00	675.8‡	-4.3	+ 10.1	+ 10.0
Turkey	1.36	1.38	2.60	16.78	24,175.9	-4.4	- 3.2	- 3.9
EMF (MSCI)*	1.00	1.00	1.92	na	534.1	-3.7	- 1.5	- 1.5
EMBI+†	1.00	1.00	1.92	na	329.2	-0.5	- 0.1	- 0.1

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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